

In the Matter of Alternative Regulatory Frameworks for
Local Exchange Carriers. And Related Matters. (Part 1 of 9)

Decision No. 94-09-065, Investigation No. 87-11-033
(Filed November 25, 1987), Application 85-01-034,
Application 87-01-002, Investigation No. 85-03-078, Case 86-
11-028, Investigation No. 87-02-025, Case 87-07-024

California Public Utilities Commission

1994 Cal. PUC LEXIS 681; 56 CPUC2d 117

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(See Appendix A for appearances.)

[*1]

Daniel Wm. Fessler, President; Patricia M. Eckert, Norman D. Shumway, P.
Gregory Conlon, Jessie J. Knight, Jr., Commissioners

OPINION: INTERIM OPINION

I. Executive Summary

This order concludes the Implementation Rate Design (IRD) proceeding, the third phase of our investigation (I.87-11-033) into the design of a New Regulatory Framework (NRF) for GTE California Incorporated (GTEC) and Pacific Bell (Pacific). This phase of our investigation settles two inquiries simultaneously: an inquiry into the further extension of competition within the Local Access and Transport Areas (LATAs), and an inquiry into the proper level of pricing and pricing flexibility authorized for local exchange companies (LECs) who will be competing to retain customers of competitive telecommunications services.

This case is narrowly focused on the arrival of intraLATA competition, the appropriate extent of that competition, and the requirement for pricing flexibility for the LECs concurrent with the arrival of competition. Competition is expected to bring a wide array of choices to consumers and enable both LECs and the interexchange carriers (IECs), their competitors, to **[*2]** invest in a diversity of telecommunications services, to the ultimate benefit of consumers.

In Decision (D.) 89-10-031, which adopted the NRF for GTEC and Pacific, we foresaw a growing number of alternatives to LEC services. In response, we devised an incentive framework which separated services into three categories: Category I - monopoly services for which no competition is authorized; Category II - discretionary or partially competitive services for which competition is authorized, with pricing flexibility between appropriate price ceilings and price floors; and Category III - fully competitive telecommunications services with full pricing flexibility and minimal tariff requirements. These three categories form the framework for the development and application of key pricing policies in this decision.

An important dimension to this order is that while our pricing policies for competitive services set the stage for competition for intraLATA toll and other telephone services, these policies are intended neither to result in a windfall to the NRF companies nor to deprive GTEC or Pacific of a fair opportunity to earn a competitive rate of return. To accomplish this balancing, [*3] every rate change ordered by this decision which results in a revenue increase or decrease is offset by countervailing rate changes or revenue adjustments so that the cumulative effect of all revenue changes for each NRF company is zero (revenue neutrality). Because of interactions among the components of the rate design, however, achieving revenue neutrality can be complicated. For example, as we lower rates for competitive services, customers' use of these services will increase, resulting in additional revenues. Additional net revenues expected from the stimulation of toll, toll-like services, and switched access services can serve to lessen the need for rate increases for other services. To derive these additional revenues and associated costs, we estimate the volumes of additional toll calling resulting from the adopted rates by applying appropriate demand elasticity factors.

In addition, the goal of revenue neutrality put some constraints on our ability to follow the general pricing policies that we had hoped to follow consistently in developing the rate design. The limitations of the revenue rebalancing have forced us to deviate from our preferred pricing principles in [*4] many instances throughout this decision.

Both GTEC's and Pacific's rate designs result in new rates effective January 1995, and any existing recurring surcharges or surcredits carried over from previous years will be eliminated. Final rates are established for January 1, 1995, without revenue rebalancing surcharges.

Authorization of Competition

This order authorizes competition for toll and toll-like services. Calls placed under the Zone Usage Measurement (ZUM) zone 3 schedule (13-16 miles) are retained as a Category I monopoly service. Inter- and intraexchange private line services and special access services are open to competition and are consolidated into fewer rate schedules, as proposed by GTEC and Pacific, with any existing resale restrictions on private lines lifted. Centrex and CentraNet services and Private Branch Exchange (PBX) trunks are authorized for competition. However, the restriction against competition for local loop services is retained. Local (IntraLATA) Directory Assistance services remain a Category I service, but IEC Directory Assistance has been moved to Category II. Foreign exchange services remain a monopoly Category I service. Credit card, [*5] coin operated, operator-handled, and 0+ or 0- calls placed from pay telephones may be handled by any certificated competitor, and toll services may also be resold by third-party certificated providers when calling cards are used.

The GTEC Rate Design: Modified Cost-Based Pricing

Today's decision will permit each company to have a fair opportunity to recover its authorized revenue requirement based on its own array of services. GTEC's current surcharge of about 15% on exchange services will be eliminated, and the price of each of its services will be known to the consumer and fixed as of January 1, 1995. GTEC's rate design reflects four guiding principles: (1) residential basic exchange rates, including flat rate service, measured rate service, and installation charges will be set below their direct embedded cost (DEC) in order to continue progress to achieve the universal service goals of

this Commission; (2) all other monopoly Category I telephone services will be priced either at their current price or at their DEC, whichever is higher. This principle assures that the rates for all telephone services not marked for special treatment will recover their DEC's, while consumers [*6] currently paying more than DEC's will pay the current rate and will therefore benefit from the removal of the 15% surcharge from the current prices for exchange services; (3) all telephone services reclassified from Category I to Category II are priced at DEC or the company's proposed rate, whichever is higher; and (4) all services already in Category II will be priced at the company's current rate or DEC, whichever is higher. These four principles guide the rate design for GTEC's overall services, with limited exceptions as described in the text of this decision.

Pacific's Rate Design: Cost-Based Pricing

Pacific's rate design is derived from cost-based pricing principles. Pacific's residential basic exchange services are priced below DEC and installation charges are set at current levels, in deference to universal service goals of this Commission and of this state. Otherwise, Category I monopoly services are set equal to DEC, and then reduced by 5% to accommodate the constraints of the revenue rebalancing. (For competitive reasons, switched access services are priced at DEC with no percentage reduction.) Category II services are set at the company's proposed price, or [*7] at the price floor (either long-run incremental costs (LRIC) or DEC, whichever is lower) if the company's proposed price is below the price floor. For Pacific's rate design, no distinction is made between services newly shifted from Category I to Category II and existing Category II services; in both cases the company's price is adopted as long as the price remains above the price floor. However, we deviate from these general principles for some of Pacific's services. Detailed explanations for such deviations are found in the following chapters.

Local Measured Usage

For both GTEC and Pacific, local measured usage, i.e., calls between 0 and 12 miles, is retained as Category I monopoly services with no downward pricing flexibility. However, the LECs are prohibited from blocking certain types of calls completed within the local area. This is intended as a convenience to the customer who may desire to use an alternate provider, and as a convenience to LECs and competitors who will not have to concern themselves with blocking or blocked calls. GTEC's local usage (including Foreign Exchange Service (FEX) usage and pay phone usage schedules) will be maintained at current [*8] rates. Pacific's local usage and FEX usage will be set at DEC minus 5% and the FEX usage premium is eliminated. Pacific's Customer-Owned Pay Telephone (COPT) usage is also based on DEC minus 5%, but 1 cent is added to each call to fund directory assistance service.

Local Transport and Switched Access

In keeping with our overall policy of cost-based pricing, we eliminate the Carrier Common Line Charge (CCLC) as a revenue source for the LECs. We set rates for Pacific's switched network access and local transport service at DEC, and for GTEC's corresponding services at the proposed rates. Transport services remain in Category I, pending further examination of this issue in the Commission's Open Access and Network Development (OAND) proceeding, (Rulemaking (R.) 93-04-003, Investigation (I.) 93-04-002), which addresses central office access and unbundling of the transport service, among other issues. The

mileage-sensitive transport rate is eliminated for both Pacific and GTEC, and switched transport services are priced at DEC for Pacific and at proposed rates for GTEC.

Universal Service Goals and Lifeline Service

It is the well-established policy of this Commission [*9] and this state that the value of the telephone network to all subscribers is enhanced as a greater portion of the state's population is connected to the public switched network and may be reached by anyone calling into California's local networks. It is our goal to ensure that nothing in this rate design hinders the future attainment of telephone service by at least 95% of California's households. The recommended overall change in prices is intended to balance increases in local exchange monthly rates against substantial discounts in toll services, so that total bill impacts on customers are minimal and do not impede the goal of universal service.

While we are committed to keeping basic service affordable, the record in this case also indicates that even at an affordable level of pricing, many low-income, nonwhite, and particularly non-English-speaking people who can afford regular telephone service or who are eligible for lifeline phone service do not have telephones. In part, this may be due to a lack of information about ordering and maintaining telephone service. Whatever the reasons may be, the record strongly suggests that both GTEC and Pacific must significantly improve [*10] their customer outreach and educational programs to achieve a 95% penetration rate for phone service among nonwhite and non-English-speaking households. This order examines the record from the workshop on universal service goals and sets targets for both GTEC and Pacific to increase their penetration rates by better educating and informing all customer groups about service connection and affordable rate plans.

In addition to better consumer information, a key component to universal service is a lifeline rate which makes telephone service affordable for low-income customers. The cost of maintaining this necessary subsidy should be borne by all end-users of certificated telecommunications services through a surcharge, since all end-users benefit from the value of a universal network. All subscribers should recognize the economic efficiency of directly subsidizing lifeline service, so that the essential access to medical and family support systems and the ability to seek employment and remain employable are maintained. All telecommunications customers share in support of lifeline programs and will benefit from the societal value of lifeline programs; therefore, surcharges are assessed [*11] on all end-users in order to pay for these social goals, which include the Universal Lifeline Telephone Service (ULTS) program and the DEAF trust program. A uniform statewide lifeline rate is adopted for all LECs, except certain small LECs. LECs will offer eligible customers lifeline service at one-half of Pacific's flat and measured service rates and charges (\$ 5.62 and \$ 3.00, respectively). Statewide service connection charges for ULTS customers are set at \$ 10.00 for the initial telephone installation.

Small and Mid-Sized Local Exchange Companies

This proceeding focused primarily on rate designs for the two NRF companies. Rate design for small and mid-sized companies is appropriately done either when a company requests authority to operate under the NRF or in the course of each company's next general rate case. Small and mid-sized companies have participated vigorously in this case, mainly to alert the Commission to the potential impacts on them of intraLATA competition and the new rate design for

Pacific and GTEC. This order recognizes that small and mid-sized companies have been dependent on toll and access revenues and intercompany settlement revenues to recover [*12] Commission-authorized revenue requirements. Intercompany settlement pooling will continue after the implementation of intraLATA competition with settlement payments to small and mid-sized companies offsetting losses in access and toll revenues up to the statewide service average rate of return. The small and mid-sized LECs may increase rates for basic monopoly service by as much as 100% of the current tariff rates, or up to a rate level of 150% of Pacific's basic exchange rates, whichever is lower. The California High-Cost Fund (CHCF) will continue to be available to small and mid-sized LECs that file general rate cases by December 31, 1995.

Contracts and Imputation

Finally, this order restates and clarifies the appropriate standards for imputation of price floors for contracts and for the LECs' bundled competitive services using monopoly building blocks. All requests for approval of contracts and for pricing flexibility for bundled services that include monopoly building blocks are expected to follow the imputation standards adopted in this decision. LECs must continue to file contracts with the Commission with full disclosure of all contract terms and conditions available [*13] to Commission staff. Contracts with prices above the servicewide floor price can be filed under the Express Contract Procedure and are effective in 14 days.

Conclusion

This order completes the investigation into intraLATA competition and rate design for the new incentive framework implemented in D.89-10-031. This order takes another step in the transition from traditional regulation of monopoly telephone service to a fair and fully competitive market for telecommunication services. As part of our next steps in this transition, we will consider presubscription for toll calling, so that customers who wish to use a provider other than their LEC will not be required to dial 10 plus three digits (known as 10XXX dialing) to access an alternate provider.

II. IntraLATA Competition and Rate Design Philosophy

A. History

Until a decade ago, telecommunications services in the United States were provided by monopolies, which were subject to traditional economic regulation at both the state and federal levels. This arrangement ended with the divestiture of American Telephone and Telegraph Company (AT&T), which opened the door to competition in telecommunications services. [*14] Divestiture was effected by an antitrust consent decree between the U.S. Department of Justice and AT&T (the Modified Final Judgment (MFJ)).

By I.83-06-01, initiated on June 29, 1983 to consider the effects of the MFJ, this Commission recognized the changed nature of this industry and authorized intrastate interLATA competition. The introduction of competition in the long distance market began a transition for Californians from an environment in which one company provided all telephone services, to a competitive world where consumers choose among various providers of long distance and other telecommunications services.

The role of the Commission since divestiture has increasingly been to manage this transition from monopoly to competitive telecommunications services. In

managing this transition we have tried to assure that competition between the LECs and their new competitors is fair, that profits from monopoly services are not used to subsidize the LECs' offerings in competitive markets, and that telecommunications companies under our jurisdiction do not engage in anticompetitive practices.

Another challenge of this transition is assuring that the burdens of the traditional [*15] monopoly companies for funding programs for disadvantaged customers are shared in the future among all competitors. We seek to maintain fairness between competitors and the monopoly companies, and also to permit the LECs to receive adequate revenues to meet the costs of continuing to provide monopoly services. As monopoly companies offering a mix of competitive and monopoly services, the LECs' ability to respond effectively to a competitive environment rests upon the Commission's assurance that the number of services requiring subsidies from more competitive offerings will be limited and subsidies will be targeted to meet identified needs as efficiently as possible.

We have previously authorized competition in interLATA message toll services (MTS), coin operated telephone sets, Directory Yellow Pages, high-speed digital private line services, inside wire installation and maintenance, and sale of customer premises equipment.

Many states have also authorized intraLATA toll competition, but in California only the LECs may currently offer intraLATA toll service. The prohibition of intraLATA toll competition has proved difficult to enforce, however, because advances in telephone technology [*16] provide users an increasing ability to bypass the local network, and because LECs have a diminishing ability to block toll traffic based on boundaries drawn as part of the MFJ. For example, once 800-prefix numbers (toll-free to the caller) are dialed and sent, the network will complete the call, whether the communication occurs entirely within the LATA or not. When 800 service provided for interLATA or interstate use connects callers within a LATA, the LEC loses revenues it might otherwise have received. The same result occurs when a Wide Area Telephone Service (WATS) line is used to make intraLATA calls.

The erosion of the LECs' theoretical monopoly over intraLATA MTS calling is an inevitable outgrowth of setting regulated prices for toll services higher than the economic cost of the service. Artificially high-priced services present easy targets for competitive intrusion. In response to increased competition, technological change, revenue erosion, and other considerations, in 1987 the Commission took the first step to convert the regulation of the LECs to an incentive form of regulation, more suited to the competitive, rapidly changing world of telecommunications services. [*17] The Commission wanted to explore the implications of both relaxing its ban on intraLATA competition and reforming its pricing policies. On September 24 and 25, 1987, it held en banc hearings to receive comments from 22 parties regarding the need for changes in the regulation of LECs.

The IECs who commented strongly urged the Commission to open the LATAs to MTS competition and to move intraLATA access charges towards cost, contending that this would benefit customers without having an adverse impact on universal service.

Following these hearings, the Commission instituted I.87-11-033, the present proceeding, to reconsider the regulatory framework for California LECs. The order instituting this investigation divided the proceeding into three phases:

Phase I: Price flexibility for services subject to competition;

Phase II: Alternative approaches to ratemaking for basic rates; and

Phase III: Pricing flexibility and competition for intraLATA message toll and related services.

1. Phase I

A settlement of Phase I issues, examined in D.88-08-059, 29 CPUC2d 11, and adopted in modified form in D.88-09-059, 29 CPUC2d 376, allowed limited downward pricing flexibility for LECs' vertical [*18] services, n1 Centrex and similar services, and high-speed digital private line services, and extended interim guidelines for special contracts. It also allowed competition in the provision of intraLATA high-speed digital private line services, subject to certain conditions. n2

n1 D.88-09-059 limited vertical services to the following existing services: call waiting, call forwarding, busy call forwarding, busy call forwarding-extended, delayed call forwarding, three-way calling, speed calling in all forms, intercom, direct connection in all forms, call restriction in all forms except 976 blocking, call hold, and call pickup. (29 CPUC2d at 385.)

n2 D.88-09-059 allowed competition in intraLATA high-speed digital private line services. High speed was defined as 1.544 Megabits per second (Mbps) or above. (Id. at 387.)

2. Phase II

Phase II culminated in D.89-10-031, 33 CPUC2d 43, which adopted an incentive-based new regulatory framework (NRF) for GTEC and Pacific. NRF centered on a price cap indexing mechanism with sharing of excess earnings above a benchmark rate of return level. The Commission also separated LEC services into three categories: monopoly services [*19] (Category I), partially competitive or discretionary services (Category II), and entirely competitive services (Category III).

Prices for Category I services remain subject to Commission approval; the LECs have flexibility to reduce prices for Category II services from Commission-approved price caps; and the LECs have the maximum lawful flexibility to set prices for Category III services.

The Commission determined that downward flexibility was warranted for the then-current information access services, high-speed special access services, and billing and collection services, because these services were discretionary or partially competitive. D.89-10-031 set initial price caps for Category II services at the rate level in effect at the time pricing flexibility for a particular service is implemented; price floors were based on direct embedded costs (DEC), pending adoption of an appropriate long-run incremental cost (LRIC)-based price floor.

D.89-10-031 also tried to ensure that LECs under NRF would not favor their own competitive services. We adopted the principles that monopoly utility services should be unbundled and made available on a nondiscriminatory basis to potential competitors, [*20] unless extenuating circumstances, demonstrated on a service-specific basis, justified a different treatment. We also required the LECs to impute the tariff rate for monopoly functions included in a bundled tariffed service to promote fairness to competitors.

Finally, Phase II set forth seven goals for the NRF as guidance for future incentive regulation: universal service; economic efficiency, including pricing efficiency (prices are based on the true cost of service) and productive efficiency (firms minimize their costs of production); encouragement of technological advance; financial and rate stability; full utilization of the local exchange network by retaining customers and adding new services; avoidance

of cross-subsidies and anticompetitive behavior; and low-cost, efficient regulation. (33 CPUC2d at 92-115.) These goals were pursued in Phase III.

3. Phase III

Phase III began in 1991 with two primary goals: to examine opening the LATAs to toll competition and to consider reducing LEC toll prices, which would enable LECs to compete in a competitive intraLATA market and in the long term to retain robust public switched networks able to deliver low-priced toll services [*21] to all customers. At the outset, the rate design change was intended to be revenue-neutral, i.e., to shift revenues between services and customer classes without any change in the base year revenue requirement (1989 for Pacific and 1990 for GTEC), except as modified by subsequent Commission decisions. The investigation into opening the intraLATA toll market and the associated rate rebalancing began in September 1991.

On September 17, 1993, we adopted D.93-09-076 as our decision in Phase III. Shortly afterwards questions were raised about the fairness of the decisionmaking process, including allegations of irregularities in the preparation of the final decision. We immediately took steps to determine whether such irregularities had occurred and, if they had, to deal with their effects. These steps included the appointment of an investigation team consisting of our General Counsel, the Chief Administrative Law Judge and the Director of the Commission Advisory and Compliance Division (CACD).

Many of the initial steps taken are matters of public record and recounted in the report to the Commission prepared by the investigation team and in various orders and decisions issued [*22] contemporaneously with the report. We ordered documents which had been provided to CACD and decisionmakers by Pacific and GTEC to be filed as ex parte communications and ultimately released them for review by parties and the public. We rescinded D.93-09-076 on October 6, 1993 and imposed a prohibition on ex parte communications concerning this phase of this proceeding, which remains in effect and will continue until further order of the Commission. We publicly released the investigation report.

The irregularities and our overall decisionmaking process were also subjected to scrutiny by our two state legislative oversight committees. On October 21, 1993, a joint hearing was held by the Assembly Committee on Utilities and Commerce and the Senate Committee on Energy and Public Utilities. Each member of the Commission, several senior staff members, and representatives of several parties to this proceeding appeared before the committees to offer insight as to what had taken place and to recommend steps that would both avoid any repetition of the problems that occurred and restore confidence in the Commission's decisionmaking process.

It was a valuable process, albeit a difficult [*23] one in which we considered limitations on parties' assistance in the preparation of decisions and the need for our staff to have the requisite capability in personnel, equipment and training to ensure that we can independently do any of the technical work necessary to produce our decisions.

In the course of that hearing, we made various suggestions and commitments to the legislators present. We noted the need to augment CACD's personnel, training and equipment so as to develop an independent capacity to understand and run the necessary computer models and not rely on utility or other personnel for this work. We discussed giving parties an appropriate opportunity to comment on both the rescinded decision and on the decision draft that would be proposed to replace it. All of these things have been done.

Following the rescission of D.93-09-076, and the release of the investigation team's report and the large volume of documents related to the preparation of the rescinded decision, parties were given approximately a month to provide opening and reply comments. This period was extended twice to accommodate party needs as additional documents were identified and released. The comments [*24] were unlimited as to either subject matter scope or length. These comments were ultimately of critical importance in the preparation of this current decision.

Significant changes were made in the staff and management of the decision writing process. Two new administrative law judges (ALJ), both of them Assistant Chiefs in our Division of Administrative Law Judges, were assigned to oversee the comment review and writing process. The CACD staff was augmented, new computer equipment purchased and extensive training undertaken to ensure that the CACD staff possessed the capability to undertake all necessary technical analyses independent of the parties.

We also modified our usual procedure of assigning a single Commissioner to have oversight responsibility for a proceeding and made this a matter that was the responsibility of the Commission as a whole. This change assured that each Commissioner became involved in the decision preparation as it evolved, rather than awaiting a completed draft.

The review process by the ALJs and CACD was not confined to areas of the decision about which claims of impropriety were raised. Rather, a complete review of every element of the rescinded [*25] decision was undertaken, with the parties' comments being one of the critical checklists against which the redrafting process was measured. The decision was rewritten to resolve all identified errors of law or fact, and extensively edited to improve the internal structure and clarity. This was done with an eye to preserving the basic policy directions we had previously articulated, where that was appropriate.

As the ALJs completed individual chapter drafts they were distributed to each Commissioner's office along with a cover memorandum indicating substantive changes from the rescinded decision and explanations of the revisions. Advisors met with the ALJs and CACD managers to discuss each chapter. Each Commissioner met independently with an ALJ and a CACD manager to discuss the draft.

Once a complete draft document was prepared reflecting the ALJ/CACD recommended text, it was distributed to Commissioners and noticed for a discussion at the public agenda session of June 22, 1994. The purpose of this step was for us to provide guidance to the ALJs and CACD in areas where a choice among alternatives needed to be made. A few additional technical issues were resolved by means of [*26] a memorandum from the ALJs to the Commissioners' offices. This was done in an effort to present for our consideration a complete document to be distributed for public comment as the draft decision of the Commission, not merely that of the ALJs or an assigned Commissioner. On July 20, 1994, we directed the ALJ Division to distribute the draft decision for public comment. It was a complete draft decision including all findings, conclusions, ordering paragraphs and rate tables.

The draft decision was distributed for comment on July 21, 1994, along with a memorandum from Commissioner Conlon proposing alternative treatment of various issues. Once again, there were no limits imposed as to the length of comments. Opening and reply comments were due by August 8 and August 15, respectively. Numerous parties filed opening comments and reply comments. All of those comments have been carefully reviewed and considered in developing this decision.

The decision we issue today is one of the most carefully considered decisions we have issued, as well it should be, given both its significance and the extensive public scrutiny that has attended its creation. While it has required extraordinary [*27] attention and time commitments from the Commissioners, we believe this effort is appropriate due to both the complexity and importance of the issues and the need to ensure that public confidence in our decisionmaking process is fully restored.

4. Summary

We have presented this brief history of our approach to the changing market for telecommunications services to underscore several principles that provide the framework for the remainder of this opinion.

First, this Commission has attempted to be responsive to the structural, legal, and technological developments that have transformed the market for telecommunications services from a highly regulated monopoly industry to the competitive market of today. We have opened specific services and industry segments to competition whenever conditions permitted, and we have shaped our oversight of this industry to acknowledge its increasingly competitive nature. We recognize that economic regulation originated as a surrogate for the disciplines of a competitive market, and where competitive markets evolve, our traditional economic regulation should recede.

Second, we have permitted our regulated utilities to remain in newly competitive [*28] areas on a fair basis. To be able to compete, the LECs must have the ability to react quickly to market conditions and to charge rates (prices) that are set by the market, rather than by regulation. In many cases, market pressures will lower prices to near to the cost of providing the specific service. To the extent that regulation has previously required newly competitive services to subsidize other services, the revenues supporting those subsidies may no longer be available. On the other hand, although we have encouraged the utilities' transformation into competitive entities, we have guarded against anticompetitive practices and, in particular, the potential for using profits from monopoly services to subsidize competitive services.

Third, we have acknowledged that the traditional utilities alone have an obligation to serve all members of the public. This obligation, combined with California's stated goal of "offering high quality basic telephone service at affordable rates to the greatest number of citizens" (Public Utilities (PU) Code § 871.5(a)), means that our LECs will retain their monopolies over relatively high-cost basic services. This obligation to serve and the [*29] need to pursue certain other public policy goals present us with the task of ensuring that these utilities have an opportunity to earn enough revenue to meet these obligations.

The application of these principles creates an inevitable tension. We encourage the rise of competition in telecommunications services, with the full knowledge that competitors will likely capture some of the revenues that would have otherwise gone to the traditional utilities. Yet we try to give the LECs a fair opportunity to retain sufficient revenues to permit them to carry out their obligations to serve the public and to further other worthy social goals.

This tension is clearly manifested in this opinion. Conditions are ripe for the introduction of competition in the intraLATA market. If the LECs are to compete effectively in this market, however, MTS rates must decline from their regulated levels. MTS rates have historically been used to subsidize low rates for basic exchange service, and the loss of this subsidy will require rate

adjustments to increase revenues from other services to maintain the LECs' revenues at their present levels.

Balancing these concerns is an enormous challenge, and the [*30] following discussions reflect our efforts to meet this challenge.

B. IntraLATA Competition

1. General Authorization of Competition

The majority of the comments received from the public at the public participation hearings n3 and through other means favored expanding competition within the LATAs. However, public participants differed widely on the question whether revenue rebalancing was necessary to prepare the LECs for competition. Some felt that large toll users and business customers, who will benefit most from the proposed lower MTS rates, should bear the brunt of any necessary revenue rebalancing.

n3 Hearings were held in Eureka, Redding, Sacramento, San Jose, Santa Monica, Pasadena, Anaheim, Lakewood, San Diego, San Bernardino, Victorville, San Francisco, San Luis Obispo, Fresno, and Placerville.

The LECs vary in their support for intraLATA competition, but they share a recognition of the need for a change to avoid loss of their intraLATA MTS revenues to IECs. The LECs' larger business customers are finding ways to bypass the LECs' intraLATA toll network through incidental and intentional intraLATA use of 800 services, MEGACOM (an AT&T 800 service offering), [*31] WATS, and high-speed digital private line services.

As can be seen from Table II-1, all the parties in the case either supported or took a neutral position on opening the LATAs to toll competition.

Table II-1

The Positions of the Active Parties

The following tabulation states the positions of each of the 29 active parties who filed opening briefs on the question: "Should IntraLATA Competition be Authorized?"

	PARTIES	Position on
	Competition	
LOCAL EXCHANGE CARRIERS	Pacific Bell (Pacific)	Support (p. 62)
	GTE California Incorporated (GTEC)	Support. (p.12)
	Contel of California (Contel)	No position stated
	Roseville Telephone Company (Roseville)	Support. (p. 14)
	Citizens Utilities Co. of Calif. (Citizens)	Support. (p.4)
	Calavaeras and Nine Other Small LECs (Calaveras, et al.)	Support. (p.5)
	CP National and Six Other Small LECs (CPN, et al.)	No position stated
INTEREXCHANGE CARRIERS	AT&T Communications of California (AT&T)	Support. (p.8)
	MCI Telecommunications	Support. (p. 57)

	Corporation (MCI)	
	US Sprint Communications	Support. (p.14)
	Co. (US SPRINT)	
	Bay Area Teleport, Inc. (BAT)	Support. (p. 5)
	Metro Fiber Systems of	Support. (p. 5)
	Calif., Inc. (MFS)	
	Teleport Communications	Support.(p. 5)
	Group (TCG)	
	California Assoc. of	Support. (p. 6)
	Long-Distance Carriers	
	(CALTEL)	
CELLULAR CARRIERS		
	Cellular Carriers Assoc.	No position
	of Calif. (CCAC)	stated
	McCaw Cellular Comm.,	No position
	Inc. (McCaw)	stated
	L.A. Cellular Tel. Co.	No position
	(LA Cellular)	stated
CPUC STAFF		
	Division of Ratepayer	Support. (p. 11)
	Advocates (DRA)	
CUSTOMER-OWNED		
PAY TELEPHONE		
	Intellicall, Inc. (Intellicall)	Support. (p. 2)
	California Payphone	Support. (p. 10)
	Assoc. (CPA)	
CONSUMER GROUPS		
	Toward Utility Rate	Neutral (p. 1)
	Normalization (TURN)	
	Public Advocates	No position
		stated
	Senior Utility Ratepayers	No position
	of Calif. (SUROC)	stated
	Murray, Michael/Rice,	No position
	Marybeth (Murray and Rice)	stated (p. 3)
OTHER		
	CENTEX Telemanagement (CENTEX)	Support. (p. 40)
	California Alarm Assoc. (CAA)	Support. (p. 5)
	California Bankers/LA Cnty.	Support. (p. 8)
	(CBCHA)	
	California Cable TV Assoc. (CCTA)	No position
		stated
	Department of Defense/FEA	Support. (p. 12)
	(DOD/FEA)	

[*32]

We will open the LATAs to competition for the following reasons:

First, we favor competition whenever sufficient conditions exist. Clearly, technological developments have taken us far beyond the point where it could be argued that intraLATA toll services are a natural monopoly. Judging from the number of IECs participating in California's interLATA toll market, we can safely assume that scores of eager competitors await our removal of the intraLATA ban. n4 Barriers to entry into this market are low. There is little, if any, economic justification for continuing traditional regulation of this market.

n4 In our investigation (I.92-04-008) soliciting petitions for intraLATA authority, 100 respondents filed timely petitions.

Second, competition already exists in this market, and it is time to recognize this fact. Attempting to maintain the existing arrangements would only lead to greater efforts to bypass the LECs' systems by the largest customers and to continued erosion of the LECs' MTS revenues.

Third, the disparity between interLATA and intraLATA toll rates is illogical and impossible to defend on economic grounds. An elegant rate structure would charge similar rates [*33] for comparable distances. Due to the peculiarities of California's LATA boundaries, rates for calls within the LATAs are generally, and sometimes considerably, higher than interLATA calls of the same distance. We expect competition to drive down intraLATA rates, as it has interLATA rates.

Fourth, we believe opening the LATAs to competition will stimulate new services and technologies. California customers will benefit from this competitive innovation.

Fifth, an orderly introduction of intraLATA competition, as opposed to the current de facto process, will allow us to require the new competitors to bear a fair share of the costs of maintaining universal service and pursuing other public policy goals.

Accordingly, we reclassify intraLATA toll and toll-like services as Category II services. When a service is shifted as a result of this order from Category I to Category II, competition is permitted and competitive pricing for the LECs' services is authorized. Services currently classified as Category II services are already open to competition.

We elaborate on our basic authorization of competition in the following pages.

2. Treatment of Specific Services

a. Competition [*34] for Local Services Will Be Restricted

BAT urges us to "examine the potential benefits of competition for basic exchange access services." (BAT Op. Br. p. 11.)

The main focus of this proceeding has been implementation of expanded intraLATA, interexchange competition. Consequently, the record on the effects of competition for basic exchange access services is skimpy. In this opinion, we continue to classify basic exchange access services as Category I (monopoly) services available only from the LEC. The record in this proceeding is insufficient to convince us that the potential benefits of widespread competition at this level are currently outweighed by the foreseeable harm to the LEC, particularly the loss of revenues needed to maintain uniform, affordable rates for basic exchange service.

However, it is clear that the circumstances affecting local exchange services are changing almost daily. Both IECs and cable television companies have expressed an interest in competing with the LECs at the local level. Some local cellular calls are completed to other cellular phones without any contact with the LECs' switched network. In "Enhancing California's Competitive Strength: A [*35] Strategy for Telecommunications Infrastructure," a report we submitted to the Governor in November 1993, we stated our goal of opening all telecommunications markets to competition within three years. Obviously, our hesitation at opening basic exchange services to broad competition on the basis of this record should be clearly understood to be limited to the circumstances of this proceeding.

b. LEC-to-LEC Competition For Most Category II Services Is Not Authorized

Our authorization of competition for intraLATA toll services raises the question whether we should permit LECs, in addition to the scores of IECs, to compete with each other for the toll and other telecommunications business of their customers. All LECs will initially have the same toll rates, but an issue remains concerning the desirability of toll competition between Pacific and GTEC, the two largest LECs. Although we expect that the IECs will provide each LEC with vigorous competition for these services, we will not authorize LEC-to-LEC competition at this time.

Our reasons for limiting competition in this manner are pragmatic, rather than theoretical. Even though our adopted toll rates for Pacific and GTEC [*36] are equivalent, competition between Pacific and GTEC may be based on issues other than price. With its widespread geographic presence in California, Pacific's service territory is within a few miles of many of the other LECs' customers, particularly in Southern California, where the bulk of GTEC's customers reside. Pacific's advertising presence is even greater. Thus, GTEC's customers are very familiar with Pacific and its services. For these reasons, we expect that Pacific may at first have an advantage over GTEC for toll and other Category II services, such as Centrex/CentraNet and private branch exchange services.

Our fear is that Pacific may acquire a substantial portion of GTEC's business, even without presubscription. The loss of this revenue could severely harm GTEC, which faces enough of an initial challenge in responding to competition from the IECs and in adjusting to the other changes resulting from this decision. In an effort to retain revenues for GTEC, we will prohibit LEC-to-LEC competition for Category II services at this time, with one important exception. LEC-to-LEC competition is authorized and expected for directory assistance provided to IECs.

We hope [*37] to remove the prohibition on competition between LECs, however, as the LECs mature as competitors.

c. Limited Competition For Local Usage, EAS, and ZUM

Local usage, extended area service (EAS), and zone usage measurement (ZUM) refer to services that provide calling priced below the LECs' regular toll schedules and completed within short distances of the caller's central office. n5 Local usage measures calls by time and refers to calls completed to central offices within 12 miles of the caller's central office. Separate local usage rate schedules exist for customer-owned pay telephone (COPT) and foreign exchange (FEX) services. ZUM calls include calls completed to a zone of more than 12 and up to 16 miles from the caller's central office. EAS provides all callers in an exchange with expanded local calling to specified areas that would otherwise be subject to toll rates.

n5 Local usage is often referred to as local measured usage or measured usage to distinguish this service from flat rate services.

AT&T, MCI, and Sprint argue that local usage, ZUM, and EAS should be opened to competition. (See, e.g., AT&T's Op. Br. pp. 17-22.) Because we are not yet authorizing [*38] presubscription for intraLATA or local services, this recommendation specifically requests the Commission to permit IECs to complete 10XXX (a direct dialing code used to access an IEC) n6 calls to local, ZUM, and EAS locations without being blocked. These parties also point out that for calling card n7 and operator-handled (OPH) calls to local, ZUM, and EAS locations, the LECs currently bill their customers at intraLATA toll rates (Tr. 22266). Thus, they argue, it is consistent with our decision to allow

competition for intraLATA toll calling to allow competition for calling card and OPH calls completed to local, EAS, and ZUM locations.

n6 References to 10XXX dialing also include 950-prefix dialing and other ways to gain access to some IECs.

n7 References to calling cards also include credit cards, debit cards, and travel cards used to make calls.

The parties acknowledge that local 10XXX direct dialed calls will usually be more expensive than comparable calls placed through the LEC. But since customers must consciously dial a five-digit prefix to make such calls, there is no danger of consumer harm. Customers may choose to make more expensive 10XXX locals calls because [*39] the IEC offers superior convenience, quality of service, record-keeping, or billing features (Ex. 561, p. 4; Ex. 548, pp. 6-7). In addition, the LECs' blocking of local, ZUM, or EAS 10XXX calls confuses customers at times (Tr. 26029).

AT&T and Sprint further suggest that the LECs may receive higher revenues from local, ZUM, and EAS calls placed through IECs. The IECs must pay access charges to the LEC for these calls, but the LECs would receive no incremental revenues (for flat rate and EAS calls) or low incremental revenues (for local measured service and ZUM calls) if they carry the calls themselves. (Ex. 561, p. 5.; Tr. 22313-22318.)

Pacific objects that customers would be more, not less, confused if local calls are not blocked. The IECs' discount plans may not cover local calls, and customers will be angry when they are overcharged for what should be free or deeply discounted local and ZUM calls. (Tr. 22268.) Pacific also disagrees with the IECs' suggestions that greater revenues will accrue to the LECs. The net revenues to the LECs are comparatively high for high-volume, low-cost calling within densely populated urban areas. But these are also the areas that the IECs [*40] are likely to target. To the extent that the IECs capture customers in these urban areas, the LECs alone are left with the responsibility to serve high-cost, low-volume outlying areas.

We will authorize competitors to complete calling card, OPH, and 10XXX directly dialed calls to local, ZUM, and EAS locations without blocking. These services require a customer to make a conscious choice to select an IEC, rather than the LEC, to complete the call. We believe that customers should have the freedom to make this choice, even if the IEC's price is higher than the LEC's.

Although we introduce limited competition into the geographic areas served by ZUM, EAS, and local usage, we will continue to classify these services as Category I services. All of these services are part of the basic exchange package for the affected customers: local usage is an integral part of basic business service and residential measured service; all customers in areas with ZUM automatically receive discounts for what would otherwise be billed as toll calls; and all subscribers in an EAS exchange receive expanded local calling in return for a higher basic rate. It is consistent to classify these services in Category [*41] I, with other basic exchange services.

Category I pricing policies are also appropriate for these services. At least until local exchange competition is permitted, the LECs are unlikely to face substantial competition for the provision of these services.

For these reasons, we will keep these services in Category I. The issue of recategorizing these services will be addressed when we consider opening basic exchange services to competition.

d. Centrex, CentraNet, and PBX

As discussed in Chapter IX, Centrex (or GTEC's CentraNet) and private branch exchange (PBX) services compete with each other, and these services are accordingly moved to Category II.

e. COPT

COPT services, discussed in Chapter VIII, remain in Category I while certain types of calls, such as operator-handled and calling card calls, are moved to Category II, as discussed in Chapter VII.

C. Restrictions on Use of LEC Tariffed Services

1. Use and User Restrictions

CENTEX argues that the Commission's efforts to encourage competition will be hindered unless the LECs' tariff restrictions limiting the uses and users of tariffed services are scrutinized and, if appropriate, eliminated. According [*42] to CENTEX, end-users should be free to select those services that meet their needs and to combine LEC and other services as they desire. The restrictions on users and uses in the LECs' intraLATA service tariffs are incompatible with a competitive market structure, according to CENTEX, because the LECs apply and interpret the restrictions to "thwart beneficial competition, to inhibit consumer choice and to engage in monopolistic price and service discrimination among end users."

CENTEX argues that a service cannot be deemed to be partially competitive and classified as a Category II service until the Commission has examined the LECs' use and user restrictions. According to CENTEX, any restrictions that apply to end-users and competitors of Pacific should be presumed invalid unless separately justified by the LEC or other proponent of the restriction.

CENTEX objects to several categories of restrictions that concern the use of LEC facilities to compete with toll and toll-like services, which we have classified as competitive, Category II services. The first category restricts the resale, joint use, or sharing of services. These provisions prevent an arbitrageur from purchasing [*43] toll or private line usage at bulk rates and reselling the service at a profit by aggregating end-users or subdividing high capacity private lines. The second category concerns the interconnection of private lines to customer-owned premises equipment. The third category prohibits use of feature group A (FGA) services (which allow a customer to access an IEC through a dialed number) instead of exchange services.

Our approach to this problem is guided by the principle that competition should be permitted where market opportunities and customer demand coincide. If resellers of LEC services can find or create needs for subdivided products that are not being filled by the LECs, then the Commission should not inhibit the creative repackaging of Category II services by the LECs' competitors. Since the LECs enjoy pricing flexibility, they are able to meet the competition and retain customers if they choose to pursue similar market opportunities. On the other hand, some use and user restrictions may be appropriate if they prevent a customer from functioning as an IEC while evading even the light-handed regulation that lawful, certificated IECs are subject to.

In this proceeding, the [*44] first time CENTEX specifically identified the restrictions it objects to was in its opening brief (CENTEX Op. Br. pp. 78-79). Pacific points out that CENTEX failed to propose the elimination of specific provisions during the hearings. (See Pacific R. Br. pp. 11-12.) Thus, no party had the opportunity in hearing to test CENTEX's assertions that specific tariff restrictions should be abolished. As a result, no evidence was introduced to

show how ratepayer and other interests would be affected by eliminating these restrictions.

Despite these objections, Pacific responded to each of CENTEX's concerns in its reply brief. Pacific consents to drop some of the use and user restrictions that CENTEX objects to when intraLATA competition begins. Generally, Pacific agrees that resale and joint user restrictions should apply only to services classified as Category I. Pacific would not permit joint use of MTS-like services (optional calling plans, WATS, 800), however, for intraLATA toll calling. Pacific would allow resale for Category II private lines, but not for Category I private lines. Pacific has proposed to combine its private line and special access services in a new tariff. [*45] The new tariff drops the restrictions on the connection of private lines that CENTEX objected to. Pacific would maintain its restrictions on the use of FGA switched access in lieu of basic exchange service and on joint use arrangements on wideband channels. (Pacific R. Br. pp. 71-74.)

These use and user restrictions exist largely for the benefit of Pacific or to prevent unauthorized intraLATA communications. With our decision to open the LATAs to competition, and to the extent that Pacific acquiesces to CENTEX's request, no good purpose is served by continuing these restrictions.

Pacific is therefore authorized to reflect the positions on use and user restrictions stated in its reply brief in the tariffs filed to implement this decision. The other restrictions CENTEX objected to will remain in place for now.

GTEC did not respond to CENTEX's proposals. GTEC should review its use and user restrictions corresponding to the ones Pacific has consented to drop. If GTEC chooses to remove any of its restrictions, it may file an advice letter revising its tariffs to eliminate these restrictions.

We intend to review the reasonableness of use and user restrictions in the OAND proceeding, [*46] where unbundling and access to the network are the focus of the proceeding. Without the benefit of the complete OAND record, we have the impression that restrictions justified only by the ban on intraLATA competition, a ban we remove by our decision today, are no longer necessary. Tariff provisions that merely prohibit use of LEC facilities in a manner that competes with the LEC's own Category II service should be eliminated. Ultimately, because the rules governing intraLATA competition have been changed, the LECs must bear the burden of demonstrating that these use and user restrictions are still needed. In the OAND proceeding we will assign the LECs the burden of justifying the continuation of use and user restrictions for Category II services, rather than placing the burden on those who would seek to purchase the service. If a party believes that more immediate relief from a use or user restriction on a Category II service is justified, it may seek relief in I.90-02-047 (the Forum OII).

This discussion in no way conflicts with the requirement that those who want to resell LEC services must obtain a certificate of public convenience and necessity to act as lawful resellers [*47] of telecommunications services in California.

2. Murray and Rice's Request

Murray and Rice contend that unregulated PBX owners use their PBXs to deny Universal Lifeline Telephone Service (ULTS) to qualified residential consumers and to withhold the "1+" dialing pattern permitting choice of a presubscribed interstate and interLATA carrier. They further contend that PBX telephone service providers have created telephone monopolies in many of California's

university communities. Murray and Rice ask the Commission to adopt strict tariffs to assure that PBX-served end-users have "equal unimpeded access to the intraLATA marketplace and ULTS Service." (Murray and Rice Op. Br. p. 1.)

The issues raised and relief sought by Murray and Rice in their brief are the same as those they raise in Case (C.) 90-05-023 and C.90-12-014. We will deal with these issues in those cases and not in this proceeding.

D. Rate Design Philosophy: Cost-Based Pricing

If the LECs are to be effective competitors in the intraLATA toll market, they must be able to charge competitive rates. As we mentioned earlier, current intraLATA toll rates are higher than competitive interLATA rates for comparable [*48] mileage, and this disparity supports the notion that current intraLATA rates substantially exceed the costs of providing the service.

If intraLATA toll rates drop, however, the LECs' revenues are also likely to decline. Even if the LECs were successful, in the face of vigorous competition, in retaining the toll volumes they currently serve, total revenues would fall due to the lower prices. (Increased total toll volumes, stimulated by lower prices, may offset this decline to some degree.) Compensating for this change in revenues to maintain revenue neutrality requires an offsetting adjustment to revenues and rates for other services (revenue rebalancing).

Complicating this revenue rebalancing is our reclassification of many services from monopoly (Category I) to partially competitive or discretionary (Category II) status. Resetting rates will be the subject of much of the remainder of this opinion. Our approach to this resetting is guided by a few important principles, with some key exceptions.

Our overall guiding principle is that rates should be based on the costs of providing the service. Three types of costs are discussed in this opinion. Direct embedded costs are historical [*49] costs recorded in the LECs' books of account and allocated to specific services. DECs do not include any common overhead costs, only costs that may be directly assigned to the service. Fully allocated costs (FACs) are DECs plus an allocation of common overhead costs. Long-run incremental costs are the long-term costs associated with a business decision to offer a new service or to increase availability of a new service. LRICs do not include the sunk costs of past investments. Our preference is eventually to establish LRIC as the price floor for all services, even monopoly services, in imitation of pricing in competitive markets. (See D.89-10-031, 33 CPUC2d at 128.)

In fully competitive markets, competitive pressures drive prices toward costs, and our regulation should mimic that phenomenon where competition exists or is developing. Thus, market-based pricing is consistent with our goal of cost-based pricing, and we will use the term "market-based pricing" to indicate areas where prices are driven toward cost by the disciplines of the market rather than the pronouncements of regulators. We have permitted the LECs to meet the demands of the market by authorizing pricing [*50] flexibility for fully competitive (Category III) telecommunications services.

For partially competitive or discretionary services, in Phase II we authorized pricing flexibility downward from a rate found reasonable by the Commission (the price cap). This downward pricing flexibility is limited by a price floor, which assures that these competitive services are not subsidized by monopoly services and guards against anticompetitive predatory pricing. (33 CPUC2d at 122-128.) In this opinion, we apply a general guideline, subject to several key exceptions, that the price ceiling for Category II services should

be the LEC's proposed rate, limited by the price floor. The price floor should be the DEC or LRIC of the service, whichever is lower. n8

n8 In this proceeding, the LECs' reported costs were not explicitly reviewed and tested, and we therefore do not approve specific DEC or LRICs in this decision. References to DEC or LRICs in this decision should be understood to mean the costs as reported by the LECs.

For monopoly services, prices should be cost-based, and our guideline is that rates for Category I services should equal the DEC of the service. Our goal is to reduce [*51] the need for contributions from other services to support monopoly services.

Other considerations compel us to make some key exceptions to these general guidelines.

First, our desire to promote universal service persuades us to maintain rates for residential basic exchange services -- flat rate service, measured rate service, and installation -- below these services' DEC. Low-income customers will be eligible for even lower, and consequently more heavily subsidized, rates for these essential services, consistent with PU Code §§ 874 and 875.

Second, GTEC will face sharper changes in its rates for basic exchange and other services, because its costs are generally higher (accentuating the movement toward cost-based rates) and because we are eliminating the existing surcharge of roughly 15% on bills for basic exchange services and transitional payments from Pacific for exiting the settlement pools (which helped support GTEC's below-cost rates). The need to soften what would otherwise be a precipitous change in rate levels leads us to apply somewhat different initial guidelines to setting GTEC's rates. With certain exceptions, rates for GTEC's Category I services will be set at [*52] the current rate or DEC, whichever is higher. Customers of services with current rates higher than DEC will be no worse off under this approach, and they will benefit from the removal of the 15% surcharge. Similarly, for GTEC's existing Category II services, rates will be set at the current rate or DEC, whichever is higher. For services that we reclassify as Category II services in this opinion, initial rates will be set at the higher of GTEC's proposed rate or DEC.

The third primary exception arises from the revenue rebalancing exercise. Our substantive decisions in this case produce "surplus" revenues, relative to the 1989 and 1990 revenue requirements that are assumed for the rebalancing exercise. These surplus revenues allow us to reduce rates for some services. We choose to apply this surplus to reduce rates for toll services and for Pacific's monopoly services, from the levels that otherwise would result from strict application of our pricing principles.

The different circumstances of the two large LECs require different approaches to bring revenues into balance. For GTEC, we will apply the relatively modest surplus to reduce basic exchange rates. To promote greater [*53] access to the Pacific's system, we set Pacific's nonrecurring installation charges for residential, business, COPT, and semipublic telephone service at their current rates, rather than their DEC. In addition, Pacific's surplus is sufficient to permit us to set rates for all other monopoly services, except residential access lines and switched access, at DEC minus 5%.

Although these rate reductions stray a bit from our general principle of cost-based rates, we find that this deviation is justified. First, for many services, the resulting rate is considerably closer to cost than the existing rates, and we thus make progress toward our goal. Second, these reductions help ease the transition to a more competitive telecommunications market. And third,

reducing rates for these services is the best available choice for achieving a revenue-neutral rate design.

Other exceptions to our general pricing guidelines will be discussed in connection with specific services. Many of these exceptions arise because of the conflict between our desire to implement cost-based pricing, our decision to continue support for basic exchange services, and our attempt to maintain revenue neutrality for [*54] the LECs. If we are to maintain revenue neutrality while continuing to permit some services to be priced below cost, it obviously follows that other services will need to be priced above cost (ignoring, for the moment, increases in volumes resulting from lower prices). Some of the exceptions to our general guidelines result from a pragmatic attempt to retain revenues from certain services to help support other underpriced services.

These basic principles are intended to accomplish many of the goals of NRF articulated earlier. The goals of universal service and economic efficiency are met by moving prices of Category I services toward cost and by targeting any significant subsidies to a small group of essential services. The goal of full utilization of the network is achieved when uneconomic bypass is reduced through elimination of noncost-based charges, and artificially high regulated prices are reduced to actual costs. Low-cost, efficient regulation is achieved by giving the LECs the ability to respond to market pressures for services where workable competition exists or is emerging. Financial and rate stability is achieved, for instance, when surcharges and other noncost-based [*55] charges are minimized, and customers can be certain that monthly bills will remain stable. Avoidance of cross-subsidies and anticompetitive behavior is accomplished for competitive services by imposing LRIC-based price floors and for monopoly services by moving toward cost-based prices that eliminate the contribution that could be diverted to underwrite competitive services. Finally, a cost-based rate design encourages technological advance when companies compete and innovate technically to reduce their costs, improve their services, and retain market share.

In sum, the cost-based pricing in this rate design reflects the principles of incentive regulation, is fully compatible with the goals of NRF articulated in D.89-10-031, and provides a necessary bridge from past regulation to a future, more competitive telecommunications world.

III. Basic Exchange Services

A. Summary

In this decision, we increase basic service rates for residential and business customers to bring them closer to the costs of providing these services and to compensate in part for the revenue reductions resulting from cost-based price decreases for competitive services. Pacific's monthly recurring [*56] rates for residential flat rate service, residential measured rate service, and business measured rate service are raised to \$ 11.25, \$ 6.00, and \$ 10.32, respectively. GTEC's monthly rates for residential flat rate service, residential measured rate service, and business measured rate services are increased to \$ 17.25, \$ 10.00, \$ 19.22.

As we discussed in Chapter II, we retain local measured usage in Category I. For GTEC, the daytime rate of \$ 0.04 per initial minute and \$ 0.01 per additional minute is maintained for both business and residential customers. For Pacific, we set the daytime rates at DEC minus 5%, and then apply the appropriate percentage discounts to derive evening and night/weekend rates.

GTEC's and Pacific's evening and night/weekend discounts of 30% and 60% for all local measured usage rates, including ZUM, are continued for residential, business, FEX, and COPT services.

A uniform statewide ULTS monthly rate is adopted for eligible low-income customers. The monthly rate will be \$ 5.62 for flat rate ULTS service and \$ 3.00 for measured ULTS service. The ULTS measured service allowance of 60 untimed calls remains unchanged.

These increases are intended to [*57] bring the price for basic telephone services closer to the LECs' cost of providing the services. The decision takes significant steps to keep service establishment charges reasonably low and affordable, in order to increase the statewide penetration of telephone service from the current level of about 95%.

Except for certain services, we follow our general principle, stated in Chapter II, of basing rates for monopoly services on their DEC's. For Pacific, we set installation charges at their current levels. We price other nonbasic monopoly services at DEC minus 5%. For GTEC, we retain current prices for monopoly nonbasic services when they are above DEC to help support low-priced basic exchange service. GTEC's charges for nonpublished (unlisted) numbers are raised to provide greater contribution to basic services, and GTEC's returned check charges are increased to cover the cost of providing this nonbasic monopoly service. To promote development of the network, GTEC's line extension charges and free footage allowances are kept at existing levels.

B. Background

1. Basic Exchange Service

To obtain telephone service, a customer must subscribe to the LEC's basic exchange [*58] access service. Two forms of local exchange service, flat rate and measured rate service, are available to the residential customer. Residential subscribers who meet the income eligibility criteria for ULTS may receive either flat rate or measured rate service, which is currently discounted by one-half the regular charge. Basic access service for businesses is provided on a measured rate basis. n9

n9 Business flat rate service is still provided in a few of Pacific's exchanges which are converting to measured service.

Basic exchange service has broadened over time to include more features. The monthly basic exchange rate now includes TouchTone calling at no additional charge. Subscribers to flat rate residential service can place calls within a radius of twelve miles at no additional charge.

We have not changed the actual monthly rates for basic exchange service since 1989, but adjustments to the rates authorized by our decisions have been incorporated into customer bills through surcharges or surcredits. Pacific's basic exchange customers receive a 1.8% surcredit to reflect changes since 1989, while GTEC's basic exchange customers pay about a 15% surcharge.

2. Need [*59] for Increase in Basic Exchange Rates

Under current rates, approximately 44% of GTEC's revenues are collected through toll rates, 32% through rates for local service, and 7% through switched and special access rates. This revenue distribution does not reflect GTEC's distribution of costs, but rather our previous policy of promoting telephone service for all Californians by using revenues from artificially high-priced toll and access services to subsidize below-cost residential services.

With the advent of competition, above-cost pricing of toll and access services is not sustainable. The economic efficiency resulting from basing rates on costs will ultimately benefit all telephone subscribers. In this decision we promote competition and efficiency by lowering the prices for toll and switched access services to near their DEC's. We also bring the price of business basic access services closer to their DEC's, and we move the price of residential basic access service closer to cost. We continue to price residential basic access service below cost to mitigate the effect of higher total monthly bills on customers with low toll usage.

C. Rate Design Proposals

1. Pacific [*60]

Pacific urges the Commission to recognize that intraLATA toll competition is eroding the contribution of toll revenues to basic exchange services. It recommends that basic exchange recurring rates be raised towards but not equal to LRIC, which is reported to be \$ 25 for flat rate residential service, \$ 23 for measured rate residential service, and \$ 15 for business access service. These increases should take place over three years to minimize the potential for rate shock. Pacific asserts that its proposal will maintain its residential basic rates among the lowest third for major U.S. cities. Under Pacific's three-year phase-in plan, monthly prices for Pacific's residential flat rate service would increase from \$ 8.35 to \$ 13.35, and prices for its residential measured rate service would increase from \$ 4.45 to \$ 7.05. ULTS rates would be maintained at 50% of residential flat or measured service rates. The business basic exchange rate would increase from \$ 8.35 to \$ 10.90 in one year, since Pacific believes this increase would not cause rate shock.

Pacific would increase its service connection charges as well. Charges for residential service connection would increase from [*61] \$ 34.75 to \$ 54.50 in the third year; service connection charges for ULTS customers would be limited to 50% of the residential charge. Business service connection charges would increase from \$ 70.75 to \$ 103 over a two-year period.

Local measured service, n10 which is a directly dialed switched service provided in the 0- to 12-mile rate bands, is charged on a per-minute basis. Currently the usage rate for both residential and business customers is offered in one tariff. Pacific proposes to offer business and residential usage rates in separate tariffs. The existing rate of \$ 0.04 for the initial minute of the call and \$ 0.01 for each additional minute would be maintained for residential service, while an initial minute rate of \$ 0.05 and an additional minute rate of \$ 0.018 would be charged for business service. Discounted rates for evening and night/weekend periods would be explicitly tariffed. Separate tariffs for COPT and FEX local usage would be maintained. Except for residential FEX rates, those rates would be increased.

n10 "Local measured service" will also be referred to as "usage" to eliminate confusion with measured rate access service and to distinguish usage from measured per-minute toll pricing. [*62]

2. GTEC

GTEC intends to keep basic rates reasonable and to promote the use of its local exchange network. It proposes a residual pricing approach that would first reduce its toll rates to competitive levels and increase the rates for nonbasic exchange services where possible, and then increase its revenues from basic exchange services, usage, free call allowances, and discounts. Under a five-year phase-in plan, the monthly rate for residential flat rate service would

increase from \$ 9.75 to \$ 19.60, the rate for residential measured rate service would rise from \$ 5.25 to \$ 10.15, and the rate for business service would increase from \$ 9.10 to \$ 18.95. ULTS rates would be maintained at 50% of residential flat or measured service rates.

The cost of installing GTEC's basic exchange service consists of three elements: initial order or service connection, central office activity, and premises visit. The first two charges apply in all cases, while the third applies only if a premises visit is necessary (in about 18% of residential service installations and 79% of business service installations.) GTEC proposes to increase its residential installation charges to the DEC of each [*63] service. The typical installation charge would increase from \$ 46.00 to \$ 60.00, and the premises visit charge would rise from \$ 40.25 to \$ 80.00.

GTEC proposes to increase the contribution from local measured usage through the following changes: increase the initial minute rate from \$ 0.04 to \$ 0.05; reduce the existing evening and night/weekend discounts of 30% and 60% to 20% and 40%; and eliminate the existing \$ 3.00 residential usage allowance.

3. DRA

DRA opposes the multiyear increases proposed by Pacific and GTEC because the phase-in would confuse customers and complicate the regulatory process as the Commission considers presubscription for intraLATA toll service. DRA also objects to the phase-in because it would lock in increases in rates for monopoly services while failing to guarantee any rate decreases.

DRA adopts the same residual pricing approach used by GTEC to set basic rates, but concludes that smaller rate increases than those recommended by the LECs are sufficient to balance revenues. For Pacific, DRA recommends monthly rates of \$ 10.40 for flat rate residential, \$ 5.55 for measured rate residential, and \$ 11.95 for business basic exchange service. For [*64] GTEC, DRA recommends monthly rates for basic exchange service of \$ 15.30 for flat rate residential, \$ 8.00 for measured rate residential, and \$ 17.75 for business service. For both companies, ULTS rates would be set at 50% of the corresponding residential rate.

DRA proposes to revise GTEC's three-part service installation charge by including the cost of a premises visit charge in the central office charge. According to DRA, this revision would create a rate structure that mirrors the physical network, since both the premises visit and central office charges refer to work performed on the utility's side of the network-customer interface.

D. Rates for Basic Exchange Services

1. Allocation of Loop Costs to Basic Exchange Monopoly Services

Pacific and GTEC argue that the utility strings the line and purchases switch capacity in response to the end-user's subscription to basic telephone service. According to this argument, the expense of the line and switch is incurred regardless of whether they are ever used; thus, much of the loop plant is characterized as nontraffic-sensitive (NTS). Pacific and GTEC assert that it is reasonable to collect NTS plant costs from the [*65] "cost-causer" (i.e., the end-user) through the basic monthly rate.

TURN disagrees with Pacific's and GTEC's approaches. TURN characterizes NTS plant costs as the "joint and common costs" needed to operate the switched telephone network and to provide both local and toll services; the LEC offers its subscribers the ability to place and receive local and toll calls as one of its primary services. CENTEX points out that telephone service is functionally

divided into two underlying components, access and usage; usage in turn includes both toll and local usage. Since subscribers use their network access for both local and toll calling, it is incorrect to claim that local usage is the sole cause of NTS costs. Pacific's witness admitted that it is arbitrary to allocate all fixed costs to any one service. GTEC's witness stated there is no single economically valid method for allocating shared volume-insensitive costs among services.

We concur with the general principle that NTS costs should be assigned to subscribers' basic exchange services. We must, however, make one clarification to avoid double-recovery of certain NTS costs. The residential subscriber currently pays a federally [*66] mandated end-user common line (EUCL) charge of \$ 3.50 per month per access line to the LEC; Pacific's business subscriber paid a corresponding rate of \$ 4.14 in 1989 (the Pacific rate design year) and GTEC's business customer pays \$ 5.82. The EUCL charge reflects the Federal Communications Commission's (FCC) determination of the interstate portion of NTS costs that should be collected from the basic exchange subscriber. The FCC sets the EUCL based on separations data. Our assignment of NTS loop costs to the subscriber will acknowledge the contribution to loop costs from interstate uses of the network, as quantified by the FCC. Because the LECs' cost studies include the costs of interstate access, a failure to account for the EUCL charge in setting rates would overcompensate the LEC for the costs of providing access services. We will accordingly follow a general principle of pricing monopoly access services at DEC minus the EUCL charge (with an additional 5% reduction for Pacific's services).

Our ability to follow this general principle and to recover NTS costs in the basic monthly rate for residential service is subject to a significant constraint: affordability to the customer. [*67] If the basic rate for telephone service is not affordable, customers will not subscribe, and we will fall short of our long-standing goal of universal telephone service.

2. Recurring Rates for Basic Exchange Service

a. Residential Flat Rate

For the reasons just discussed, the increase to residential basic exchange rates requires a balancing of conflicting goals. There is no precise formula to help us determine the rate levels that best balance our desire to move rates closer to costs against the need to keep residential rates affordable. We must rely on our judgment, informed by the extensive record developed on this case and by our general experience and knowledge, to perform this balancing and establish the rates that are appropriate in current circumstances.

The current monthly residential basic exchange rates for Pacific and GTEC are substantially below the reported costs of the local loop. Because of our desire to keep basic exchange service affordable, the cost basis for basic residential flat rate is one-half of FAC, rather than the DEC basis we use for other monopoly access services.

Pacific's FAC for residential basic exchange service is \$ 26.00. Subtracting [*68] the EUCL charge of \$ 3.50 yields \$ 22.50. One-half of this amount is \$ 11.25, the adopted monthly rate for Pacific's flat rate residential service.

Similarly, GTEC's reported FAC (\$ 35.55) for a residential access line, minus the EUCL charge, equals \$ 32.05. One-half of this figure is \$ 16.03. The revenue rebalancing, however, requires us to increase this figure to \$ 17.25, which we adopt as GTEC's monthly charge for flat rate residential service. Although this rate is higher than our target cost basis, it is reasonable in relation to GTEC's current effective rate. Although the current tariffed rate

is \$ 9.75, the 15% surcharge results in an effective monthly rate of about \$ 11.20. The adopted monthly rate of \$ 17.25 is \$ 7.50 more than the current tariffed rate, but because the new rate will no longer be subject to the 15% surcharge, the effective increase is \$ 6.05. In addition, customers who make some toll calls will not see a full \$ 6.05 increase in their monthly bills, because lower toll prices will produce an offsetting bill decrease. In light of these considerations, we find that a monthly residential flat rate of \$ 17.25 is reasonable for GTEC.

b. Residential [*69] Measured Rate

Residential measured service provides an economic alternative to flat rate service for residential customers who are able to limit their local calling. The current measured service rates for Pacific (\$ 4.45) and GTEC (\$ 5.25) are set at 53% of the flat rate and are within a few dollars of the flat rate. Both companies include a \$ 3.00 credit against the charges for local and ZUM calls as part of residential measured service. Since we have determined that flat rate residential service is currently priced below cost, it follows that measured rate service is also priced below cost, although the usage patterns of individual customers affect the actual price-to-cost differential.

Measured rate service is available to all residential customers, regardless of their income level. The discounts from flat rate service charges make measured rate service a practical alternative for residential customers who do not find flat rate service economical for their particular needs. Measured rate service may also appeal to customers of limited means who do not qualify for ULTS. We will retain measured rate service at a price attractive to consumers, but we will increase the [*70] monthly rate so that the price for the service captures more of its costs.

For Pacific, we will maintain the current percentage relationship between flat and measured rate service, and we set the residential measured service rate at \$ 6.00. GTEC's situation requires a reduction in the subsidy of measured service, but we want to maintain measured service as an attractive and economic option to more expensive flat rate service. For these reasons, we will set GTEC's adopted measured service rate at \$ 10.00. Measured rate service customers will continue to receive a \$ 3.00 credit against the charges for local and ZUM calls.

c. Residential Rate Levels

As we have discussed, setting the level of residential basic exchange rates involved a balancing of goals that was difficult and at times agonizing. For some services, we have concluded that, under the circumstances in the telecommunications industry today, basic rates higher than those proposed by the parties in this proceeding are necessary. This determination does not mean, as some parties have suggested, that we ignored the record in arriving at this balance. n11 Rather, it reflects the fact that we considered and grappled [*71] with the same conflicting goals that the parties did in arriving at their recommendations.

n11 Nor are we constrained from adopting these rates by the provisions of PU Code § 454, as some parties have argued. Section 454 requires utilities who file applications for changes to rates to provide notice of the proposed rate changes to their customers. Although we acknowledge that the purpose of the utility's notice is to give customers information about the application's possible effect on them, nothing in the statute prevents the Commission from adopting rates that are different -- higher or lower -- from those proposed by the utility. As a matter of practice, we have rarely found it necessary or

appropriate to grant higher revenues than the utility has requested in its application, and consequently specific authorized rates are usually no higher than requested and noticed. However, even this practice is inapplicable to this investigation, in which we are performing a revenue-neutral rebalancing to implement several important policies. If we were limited in this exercise by the specific rate proposals of the utilities that are the subjects of this investigation, we would essentially be giving the regulated utilities the power to circumscribe our authority to carry out important policies in the public interest. Nothing in the statute suggests that the Legislature intended that our authority should be so restricted. [*72]

The fact that our adopted levels of basic rates for residential services are higher than some parties recommended reflects our judgment that competitive pressures on the LECs over the next few years will be greater than these parties anticipated when they developed their recommendations. The parties, of course, had to develop their recommendations many months ago, and we have the benefit of knowing how the industry has evolved since that time. The movement toward greater competition in the telecommunications industry has accelerated at a rate that the parties would have had difficulty foreseeing.

Because of our perception of the increased level of competition, we feel a strong need to bring rates closer to costs and to reduce subsidies so that the LECs are not unfairly restricted in their ability to become effective competitors in this rapidly changing industry. Basing rates for residential flat rate service on one-half of FAC and raising rates for measured service help bring the rates for these services closer to the costs of providing the services, without moving beyond the realm of affordability. In the present circumstances and for these reasons, we conclude that the adopted [*73] rates are reasonable.

d. Business Rate

The monthly basic rate for business service, which is a measured service, does not include a usage allowance. Pacific's current monthly rate for business measured service is \$ 8.35. GTEC's corresponding rate is \$ 9.10.

Bill impact analyses introduced by the LECs show that businesses make more toll calls than residential subscribers, and are thus more likely to benefit from toll rate reductions and intraLATA service competition. Moreover, businesses have the opportunity to recover the cost of telephone service through the price of the goods or services they provide. These considerations persuade us to increase the monthly basic exchange rate for business service to recover more of the cost of providing service. We will follow the principle stated earlier and base business rates on the LECs' stated DEC for this service, minus the EUCL charge.

For Pacific, the DEC of \$ 15.00 minus its EUCL of \$ 4.14, further reduced by 5%, results in a monthly rate for business basic exchange service of \$ 10.32. For GTEC, the DEC of \$ 25.04 minus its EUCL of \$ 5.82 results in a rate of \$ 19.22.

e. Universal Lifeline Rate

Sections 873 and 874 [*74] of the PU Code require the Commission to set rates for telephone service to low-income residential customers that are no more than 50% of the basic rate for either flat rate or measured rate service. Lifeline customers are not liable for the EUCL charge. We will continue to promote universal subscriber access by adopting statewide lifeline rates that are no more than one-half the rate for Pacific's residential flat rate and residential measured rate service.

With the exception of rates charged by some small LECs, Pacific's basic exchange rates are the lowest in the state. A uniform statewide ULTS rate equal to 50% of Pacific's residential basic exchange rates provides a discount that meets or exceeds the legislatively mandated minimum. Therefore, the statewide ULTS monthly rate for residential flat rate service will be \$ 5.62; the statewide ULTS monthly rate for residential measured rate service will be \$ 3.00. In exchanges with EAS, ULTS customers will pay 50% of the applicable EAS charge. Small LECs with basic exchange rates lower than Pacific's will set the ULTS rates at 50% of the applicable rate.

The LECs may seek reimbursement for the ULTS discount (the difference between [*75] the ULTS rate and the rate charged to other residential customers for the corresponding service) from the Universal Lifeline Telephone Service Fund.

Measured rate ULTS customers will continue to enjoy a monthly allowance of 60 local calls. Additional local calls beyond the monthly allowance will be charged at the current rate of \$ 0.08 per call.

Currently, each ULTS subscriber also receives a \$ 1.00 credit for customer premises equipment (CPE) and inside wire maintenance (75 cents for CPE, as provided under § 3.3.2 of General Order (GO) 153, plus 25 cents for inside wire). When these two items were deregulated, ratepayers were given the option of continuing to subscribe on a monthly basis to LEC-provided equipment and service. It was determined that many ULTS customers are risk-averse and would prefer the insurance against breakage represented by the monthly payment to the LEC. To avoid imposing a hardship on ULTS customers as a result of deregulating CPE and inside wire maintenance, we adopted the \$ 1 combined monthly credit.

In 1988, the Commission held a workshop to discuss ULTS, which revealed that fewer than 41% of ULTS customers subscribed to the inside wire maintenance [*76] program. This low subscription level is likely due to customers realizing that inside wire has high reliability and long life. All of the workshop participants, except for Consumer Action, advocated the elimination of the CPE credit. Pacific, GTEC, and most other LECs no longer lease telephone instruments; telephone instruments are now widely available at affordable prices. The elimination of these credits would reduce ULTS costs by about \$ 30 million per year. This would be the least disruptive way of achieving some control over the ever-growing costs of providing ULTS. Therefore, the \$ 1 combined monthly credit will be eliminated. We will amend GO 153 to reflect the elimination of the 75-cent CPE credit.

3. Monthly Rates for Other Exchange Access Service

a. Party Lines

We have long advocated and required the gradual elimination of multiparty and flat rate business services because these services provide a lower standard of service than single-party and measured rate business lines. (See, e.g., D.84-06-111, 15 CPUC2d 232, 364-366, D.93367 (1981), 6 CPUC2d 441, 554.) For example, party lines may not allow immediate access to the end-user being called and do [*77] not permit a 911 operator to identify instantly the street address of the calling party.

Pacific has proposed rate increases for multiparty flat rate residential services and for single and multiparty flat rate business service. Pacific's business flat rate, for both multiparty and single-party lines, will be set at the same rate as its measured rate business service, that is, \$ 10.32 per month. In keeping with our desire to improve service quality to telephone consumers in California, Pacific is ordered to terminate its provision of multiparty and flat rate business service, to convert all multiparty business lines to single-party

service, and to convert its business flat rate service to measured rate service within one year of the effective date of this decision. Pacific may continue to provide those services to existing customers at newly adopted rates under tariff deviations while conversions are made.

GTEC has transformed all of its multiparty lines to one-party service. GTEC's former flat rate business access lines have all been converted to measured rate business service.

b. Farmerline Services

In rural parts of California, farmers have built and maintained their [*78] own facilities to connect themselves to the LEC network. Many of the historic farmerlines have been replaced by LEC facilities as once-rural areas of the LECs' territories became more populated. Pacific and GTEC maintain separate rates for the remaining farmerline services.

Pacific's current monthly rates for farmerline services are \$ 2.65 and \$ 4.95 for residential and business services. Pacific proposes to raise these rates to \$ 4.15 and \$ 6.45 per month, respectively, for the first year of its three-year phased increase for basic exchange rates. DRA proposes monthly rates of \$ 3.00 and \$ 7.50, respectively, for Pacific's farmerline residential and business customers. These rates are lower than regular basic residential and business rates in consideration of the farmers' contribution of labor and materials to maintain their portion of the lines, service drops, and protectors.

Our goal of bringing rates closer to costs leads us to raise Pacific's farmerline rates. In deference to the policy of below-cost pricing of residential service, we will maintain the present percentage relationship between residential farmerline services and regular residential flat rate service. Following [*79] this formula, we increase Pacific's farmerline rate to \$ 3.57 per residential station. Pacific's farmerline business rate is raised to \$ 12.22 per business station, which reflects the DEC (\$ 17.00) minus the business EUCL charge (\$ 4.14), less 5%. These rates are still lower than the utility's reported FAC for this service (\$ 29.00 for residences and \$ 18.00 for businesses), but will collect significantly more of the cost of service.

GTEC's current monthly farmerline rates are \$ 12.80 for party line residential service, \$ 13.85 for an individual residential access line, \$ 20.85 for a party line business service, and \$ 25.80 for a basic business access line. GTEC proposes to delete its separate farmerline service tariff and to provide farmerline service at regular one-party residential or business service rates. DRA recommends maintenance of GTEC's separate farmerline tariff schedules subject to a 55% rate increase per customer.

Consistent with our goal of providing service of equal quality to similarly situated customers, we adopt GTEC's proposal for eliminating its separate farmerline service (Tariff Schedules A-12 and A-20). GTEC shall continue to serve its existing farmerline [*80] customers as deviations from regular service, but at the corresponding one-party rate adopted in this proceeding. Thus, we adopt a monthly farmerline business rate of \$ 19.22 and a farmerline residential rate of \$ 17.25, regardless of whether the customer is served by a multi- or single-party line. These rates result in a monthly increase of up to \$ 4.45 for residential farmerline customers but provide decreases of up to \$ 6.58 per month for business rate farmerline customers.

4. Local Exchange Usage Rates

As we discussed in Chapter II, we will allow consumers increased choice and convenience by permitting IECs to complete 10XXX, OPH, and calling card calls in

local usage areas, but we continue to apply Category I pricing policies to local usage. Our full rationale for maintaining local usage in Category I is articulated in Chapter II.

Pacific observed that consumption of business local measured usage is relatively inelastic to price changes. It believes that it could use local usage rate increases to business to offset below-cost pricing for residential access lines without significantly reducing demand. GTEC based its proposals to increase local measured usage rates [*81] for all customers on similar reasoning. GTEC believes that local measured usage rate increases are justified for business customers because of the anticipated benefits to them of toll rate reductions; for residential customers, the increases encourage customers to exert greater control over their telephone bills.

Pacific and GTEC report that the DEC's of this rate element of local exchange service are generally below their current tariffed rates. For the reasons we discussed in Chapter II, the current rates for this service should be retained for GTEC. We wish to provide customers a degree of control over their monthly bills, but that control should be based on rates that reflect the cost of producing the service. Accordingly, we have raised the basic exchange rate closer to cost, but since it is still short of GTEC's reported FAC for the local loop, the current contribution from the measured usage rate will be maintained. The adopted daytime rate for the first minute of local exchange usage for GTEC is \$ 0.04 and the rate for additional minutes of use is \$ 0.01.

For Pacific, we reduce the daytime rates to their reported DEC's, and then apply an additional 5% reduction to arrive [*82] at the adopted rates, which are the same for both the business and residential schedules. The adopted first minute rate for Pacific's daytime local usage is \$ 0.0333. The rate for additional daytime minutes is \$ 0.0105.

Pacific's and GTEC's existing discounts from daytime local usage rates of 30% for evenings and 60% for nights/weekends will also be continued and applied to the local usage component of residential, business, FEX, and COPT services.

As we have discussed, calls beyond the measured rate ULTS monthly allowance of 60 local calls will be charged at the existing rate of \$ 0.08 per call.

5. ZUM and EAS Rates

As we discussed in Chapter II, although we allow IEC's calls to be completed in ZUM and EAS areas, these services remain Category I services. For GTEC, ZUM calls are priced at their present rates to preserve ZUM as a discounted option to toll service. For Pacific, ZUM daytime rates are priced at DEC minus 5%. Discounts of 30% and 60% are applied to the adopted daytime rates to develop evening and night/weekend rates. For reasons discussed in Section E of Chapter VII, we authorize Pacific to establish separate tariff schedules for residential and business [*83] ZUM services.

Pacific asks us not to establish any new EAS routes but to maintain existing routes. The EAS option has proved useful in meeting the specific needs of customers in certain areas, and we will retain our authority to create new EAS routes as appropriate; this part of Pacific's request is rejected. Existing EAS routes will be continued. We make no change in this order to EAS increments.

6. Basic Exchange Service Installation Charges

a. Basic Services

Pacific bundles the costs of all of its installation tasks, including premises visit, into a single charge. Pacific's proposed price increases for

installation of basic business exchange access service are designed to raise charges for those services to their DEC of \$ 100 immediately or within two years. Its flat rate residential installation charge would be increased to recover 80% of LRIC over three years. Pacific proposes to decrease the installation charge for residential measured service to \$ 20 to improve the affordability of this service and to promote universal service.

GTEC recommended increasing the three elements of its residential installation charge (service connection, central office activity, [*84] and premises visit) from their below-cost rates to \$ 140, which lies between DEC and FAC, and decreasing some of its other nonrecurring basic exchange charges that are significantly higher than FAC.

For Pacific, we will encourage access to the system by setting installation charges at their current levels of \$ 34.75 for residential service and \$ 70.75 for business service.

GTEC's higher revenue burden needed to recover its higher operating costs justifies setting basic business exchange installation charges at the higher of DEC or current rates. Under this approach, the business service connection charge increases from \$ 34.50 to \$ 49.57 for the initial order and from \$ 17.25 to \$ 27.49 for each additional line, the premises visit component rises from \$ 40.25 to \$ 86.64, and the central office activity charge remains at its current \$ 35.25. The corresponding residential charges will be at the higher of one-half of FAC or current rates. Under this formula, the residential service connection charge of \$ 23.00 (\$ 17.25 for each additional line) and the central office activity charge at \$ 23.00 are unchanged, while the premises visit element rises from \$ 40.25 to \$ 42.10. (See Appendix [*85] D, Tariff A-41.)

b. ULTS

Pacific proposed a special below-cost installation charge for ULTS measured service of \$ 10.00. The proposal includes a charge of \$ 10.00 for changing from measured to flat rate service in order to prevent customers from simply taking advantage of the low installation rate. GTEC concurred in these rates as an economical means for those with limited incomes to obtain telephone service.

Several of the parties proposed an installment payment plan to mitigate the expense of initiating telephone service. Pacific suggested that payments be spread out over twelve months; TURN concurred with this proposal.

Special provision is made for nonrecurring charges for ULTS customers because we realize that the cost of initiating service may be a greater deterrent to obtaining telephone service than the monthly recurring rate. To promote universal service, we approve a special \$ 10.00 installation charge for ULTS subscribers throughout the state. Ratepayers who qualify for ULTS will be charged this rate for their initial service order at each address, subject to § 3.5 of GO 153, which limits reduced service connection charges to one installation per year; other [*86] installations or service changes within the year are charged at full tariff rates. As we have discussed, the utilities may seek reimbursement for the ULTS discount from the Universal Lifeline Telephone Service Fund. LECs like GTEC that assess a separate central office activity charge are not authorized to impose that or any similar charge on the installation of a ULTS exchange access line.

A \$ 10 ULTS installation charge would leave some small LECs in violation of PU Code § 824(c), which limits ULTS installation charges to 50% of the installation charge for basic residential service. We therefore authorize a ULTS installation charge of 50% of the adopted applicable installation charge, for these small LECs.

When a ULTS customer requests a change in the class, type, or grade of service after the initial installation of ULTS service at a specific address, e.g., shifting from measured to flat rate service, §§ 3.3 and 3.5 of GO 153 provide that the rate charged shall be one-half of the otherwise applicable rate, subject to the one reduced charge per-year limitation. For Pacific, the ULTS charge for service conversions will be \$ 7.50; for GTEC the ULTS charges for such service [*87] changes will be \$ 8.62. As we have mentioned, GTEC should not assess a charge for central office activity for service to ULTS customers. The ULTS charge for a premises visit, if required, will be \$ 21.05, one-half the rate that would otherwise apply.

Section 3.6 of GO 153 allows ULTS customers to pay service connection charges in three equal installments. We are not persuaded that it is necessary to extend the payment period to 12 months, as Pacific and TURN propose.

c. 90-Day Waiver

The adopted rate changes may cause residential customers to reevaluate the cost-effectiveness of flat rate versus measured rate service in light of their individual calling patterns. Since our adopted rate design brings rates closer to costs and is more economically efficient, we should permit residential ratepayers to take advantage of cost-based rates. Therefore, DRA's proposal to waive service connection charges for a 90-day period after the IRD implementation date is approved. Residential customers who request conversion from flat rate service to measured rate service, or vice versa, will be exempt from service connection charges for a maximum of two changes per access line during this [*88] time. Consistent with D.90-11-058, no revenue adjustment is made to allow recovery of the potential LEC costs associated with these changes.

d. GTEC's Premises Visit Rate Element

DRA noted that the structure of GTEC's installation charges created a capacity for inappropriate assessment of the premises visit charge, for example, when the work to be done was actually on the network side of the demarcation point or was within the scope of another tariffed service. DRA presented evidence that the ambiguity with regard to application of the premises visit charge in GTEC's Schedule A-41 tariff creates a possibility for misapplication and overcharging. DRA's proposal to consolidate the central office activity and premises visit elements of GTEC's installation rate would eliminate the possibility of overcharging.

GTEC claims that its separate premises visit charge is consistent with cost-based pricing, and we agree. DRA's proposed combination of central office and premises visit elements would send an incorrect signal to GTEC and its customers. Moreover, the separated installation elements are consistent with our movement towards unbundled tariffing of services, which enables [*89] customers to avoid incurring the costs of services they do not use. The proper solution to any ambiguity in GTEC's tariffs that leads to customers' paying unwarranted charges is not to roll those charges into all customers' rates, as DRA proposes. GTEC's customers should not be penalized by paying a higher installation charge because ambiguity in GTEC's tariffs led to some customers' being charged the improper unbundled rate. The proper solution is to clarify and enforce the tariff.

We will therefore retain GTEC's unbundled rate design, but we will not ignore suggestions that misapplication of GTEC's unbundled tariff resulted in overcharges of unsuspecting customers. We direct CACD and DRA to commence an investigation of GTEC's practices regarding the installation tariff. We will not tolerate misapplication of any tariff, and particularly installation tariffs,

which have an integral link to achievement of our universal service goals. If this investigation uncovers evidence of systematic tariff violations, we will not hesitate to commence formal proceedings to assess appropriate fines and penalties against GTEC and to order restitution of any overcharges.

e. Line Extensions [*90]

LECs have historically provided significant free footage allowances through line extension facilities n12 and service connection facilities n13 to applicants for new telephone service in areas of the LEC's service territory where lines had not previously been installed. These new facilities are treated like any other utility plant dedicated to public service.

n12 Line extensions consist of distribution cable (wire intended to serve more than one end-user) usually placed along common easements.

n13 Service connections are wires that are usually placed on private lands to serve only one end-user.

Pacific does not propose to change the free footage allowance for line extensions and service connection facilities. On the other hand, GTEC would reduce its current line extension allowance of 700 feet to 300 feet and its service connection allowance of 300 feet to 100 feet. However, its excess footage charges would not be changed.

The effect of GTEC's proposal is to reduce, by redefining GTEC's service obligation, GTEC's cost of doing business. IRD would be employed to provide the equivalent of an automatic productivity increase to GTEC in the area of line extensions, particularly [*91] since GTEC has not provided any test year volumes to show the revenue impact of its proposal. This proposal, though relatively minor in the scheme of IRD, would interfere with the operation of the NRF. In addition, any changes in LEC line extension or service connection free footage allowances should be done in a proceeding such as I.90-02-047, where California's developers and construction industry representatives would have an opportunity to be heard on any proposed diminution of service.

Accordingly, GTEC's request to reduce its free footage allowances is denied.

f. Supersedure

Telephone service supersedure is the process by which the named subscriber for an existing service is changed but no change in service features or facilities is made. In such instances, the newly named subscriber assumes full responsibility for payment of currently unpaid service and subsequent service provided to that telephone number.

A separately stated supersedure tariff can be a useful tool in promoting universal service. It allows a simple change to the named subscriber to a service to be made at a lower price (reflecting the lower costs the LEC incurs) than the charge for initiating service [*92] that would otherwise apply.

Pacific's nonrecurring charge for supersedure of service is \$ 5 for each residential line and \$ 7 for each business line. GTEC does not have a separately stated nonrecurring charge for supersedure, but treats it as an initial order under its Tariff Schedule A-41, Special Condition 4. This results in a current charge of \$ 23 for the first residential line, \$ 34.50 for the first business line, and \$ 17.25 for each additional superseded residential or business line. For its CentraNet service customers with the Direct Inward Dial (DID) service feature, GTEC does not levy a supersedure charge. Neither GTEC nor Pacific requested any change to their supersedure prices or practices.

Based on our Category I pricing principles, Pacific's supersedure prices should be moved to DEC minus 5%. However, Pacific did not conduct cost studies of supersedure. We reluctantly allow Pacific to continue its current supersedure charges. GTEC's prices for initial installation, which GTEC charges for both supersedures and initial orders, should be increased to the levels we have adopted above under subsection 6(a) of this Section.

7. Special Local Calling

a. Repair [*93] Service (611)

(1) Explanation of Repair Charges

Repairs to facilities on the company side of the standard network interface (SNI) are made at no charge to the customer calling for repair service. Visit charges apply only when the need for repair is found to be on the customer side of the SNI (inside wire), and cover only the work necessary to locate the source of the problem. If a customer who does not subscribe to LEC's inside wire maintenance service, discussed below, requests the LEC to make inside wire repairs, time-based charges will also apply.

During our public participation hearings, some participants complained about the way GTEC presents its repair charges. According to these customers, when a customer contacts GTEC's repair service, GTEC's representative will explain how the customer may test the phones and inside wire and may either fix it or, if required, have it checked and repaired. The GTEC representative will also inform the customer that the current visit charge of \$ 68 and the \$ 85 hourly rate will apply if GTEC finds the cause of the problem to be on the customer's side of the SNI, and performs the work to fix the problem. Mentioning these charges, [*94] even before the utility verifies that the problem is on the customer's side of the connection, often irritates customers.

Pacific also discusses the customer's responsibility for inside wire maintenance, but customer liability, instruction on how to test inside wire to avoid a technician's visit, and the charge for inside wire service are discussed only after Pacific has ascertained that the reason for faulty service lies on the customer's side of the SNI.

Pacific's approach appears swifter, less confusing, and more customer-oriented, and we therefore recommend it highly. We note that quality of service is an issue identified for comprehensive review in the periodic NRF reviews.

(2) Visit Charge

GTEC's current visit charge of \$ 68.00 is below its DEC of \$ 86.64. Following our pricing principles, we raise this charge to \$ 86.64.

b. Directories and Directory Assistance

(1) Local Directory Assistance (411)

The database of end-user telephone numbers is compiled and maintained by the LEC. Local directory assistance service provides the calling party with information about numbers within the caller's area code -- either the requested telephone number or information [*95] that the requested telephone number cannot be found. Directory assistance is currently an LEC monopoly service. The residential basic exchange service of Pacific and GTEC includes five free directory assistance calls each month. Business basic service and Centrex/CentraNet customers have an allowance of two free calls and one free call, respectively. Up to three numbers are furnished per inquiry. Currently, there is no charge for directory assistance calls made to other area codes within the LATA.

GTEC proposes to limit residential customers to two free directory assistance calls per month, to eliminate the call allowances for business and CentraNet customers, and to reduce the number of listings given per inquiry from three to two. It concurs with DRA's proposal to charge directory assistance calls to other area codes within the LATA in the same manner as local directory assistance calls.

Pacific concurs with DRA's recommendation to increase its directory assistance charge for calls exceeding the monthly allowance from \$ 0.25 per call to Pacific's FAC of \$ 0.32 per call. Pacific also agrees with DRA's recommendation to eliminate the free directory assistance allowance, except [*96] for the residential allowance of three calls per month. Pacific and DRA also agree that directory assistance calls to other area codes within the LATA should be assessed the same charges as local directory assistance calls.

DRA also proposes to raise GTEC's directory assistance rates from \$ 0.25 to GTEC's reported FAC of \$ 0.29 per call.

Local directory assistance is a Category I service. It is a nonbasic monopoly service, fundamental although not required for access to the LEC's switched network. While our goal is to open services to competition whenever conditions permit, customer listings and access to LEC data bases used for directory assistance raise significant privacy concerns. If we were to authorize competition, it would require making customer listings available to potential competitors. The attendant privacy issues are beyond the scope of this proceeding. We prefer to address competition for local directory assistance in a proceeding better suited to explore all related privacy issues. Thus, we will continue to classify local directory assistance as a Category I service.

For pricing purposes, however, it is appropriate to reflect the nonbasic, discretionary nature [*97] of this service and to make adjustments based on the requirements of the revenue rebalancing.

A local directory assistance rate of \$ 0.35, GTEC's proposed rate, will be charged to business and residential access customers of GTEC for calls exceeding the monthly allowance. For Pacific, we will maintain the local directory assistance rate at \$ 0.25, as a convenience to customers and to balance revenues. For customer convenience, we will also continue the existing free call allowances for GTEC and Pacific of five calls for residential, two for business, and one for Centrex or CentraNet services. These free call allowances and charges will apply to directory assistance calls to all area codes within the LATA.

GTEC recommended reducing the number of requests allowed per directory assistance call from three to two. Although the purpose of this recommendation is to generate revenue, we believe that the incremental revenue effect would be minuscule and would be far outweighed by an increase in customer inconvenience and dissatisfaction. GTEC's proposal is rejected.

(2) IEC Directory Assistance

IEC directory assistance is similar to local directory assistance, except that it provides [*98] information about numbers in LATAs other than where the call originates and it uses the facilities of an IEC. The IECs are essentially resellers of LEC directory assistance; the IECs purchase this service from the LECs and bill their end-users under their own tariffs. Currently, there is limited competition between GTEC and Pacific, primarily in the Los Angeles area, for the provision of wholesale directory assistance service to IECs.

This service is currently a Category I service. However, GTEC and Pacific agree that this service should be moved into Category II because the service is competitive and is likely to become increasingly so. Neither Pacific nor GTEC advocates a rate increase; Pacific requests a nonpublished price floor set at or above LRIC. DRA asserts that competition is limited to Southern California and exists only between Pacific and GTEC because those companies share listings not available to others. DRA recommends keeping the service in Category I and pricing the service at FAC, since the competition for Pacific's IEC directory assistance service is geographically limited. DRA recommends increasing Pacific's IEC directory assistance rate to \$ 0.33 per call [*99] and increasing GTEC's IEC directory assistance rate to \$ 0.30 per call.

Even DRA agrees that other non-LEC directory assistance providers may soon emerge. We therefore find that IEC directory assistance is partially competitive, and shift it to Category II.

Pacific's current rate is \$ 0.29 per call and GTEC's rate is \$ 0.245 per call. These rates are above the price floor for the service. We will retain Pacific's current rate of \$ 0.29, but we will increase GTEC's rate to its DEC of \$ 0.28 due to the need to retain revenue in the rebalancing. The rates will allow the two LECs to compete on a fair basis.

Resolution of further issues involving IEC directory assistance, such as payment by GTEC or Pacific for each other's directory listings, should await further action in I.90-01-033.

(3) Nonpublished Listing and Nonlisted Services

GTEC's "Directory Nonpublished Listing Service" causes a customer's listing to be omitted from both published directories and directory assistance data bases. The current rate is \$ 0.60 per month; GTEC proposes to raise the rate to \$ 1.50 per month. Pacific does not propose to increase its \$ 0.30 per month charge for nonpublished listing service. [*100]

GTEC also proposes a new service called "Directory Nonlisted Listing Service" which causes a customer's listing to be omitted from published directories, but the number is available through directory assistance. GTEC suggests a monthly rate of \$ 1.00 per month.

These are discretionary services, and we place them in Category II. Under our pricing principles, we set rates for new Category II services at the company-proposed rates, except as limited by price floors. We adopt GTEC's proposed rate of \$ 1.50 for Directory Nonpublished Listing Service and \$ 1.00 for Directory Nonlisted Listing Service, reflecting the discretionary nature of the service purchased from the LEC.

(4) Additional Listing and Additional Line of Information

Additional Listing and Additional Line of Information provides telephone subscribers with an additional listing or line in published directories of information pertaining either to the subscriber's primary telephone number or to a different telephone number.

Pacific's current charge for these services is \$ 0.50 per month for additional lines for both business and residential customers and \$ 0.50 and \$ 1.00 for additional residential and business listings, [*101] respectively. DRA recommends increases to \$ 0.85 and \$ 1.75 per month, respectively, for both types of services. Pacific agrees with this recommendation.

These services are discretionary Category II services. Consistent with our Category II pricing policy, we adopt the proposed increased rates for these services as recommended by DRA and Pacific.

GTEC did not propose to change its rates for additional listing and additional line of information for review. Those rates will be maintained at current levels.

(5) IEC Listing

To implement the Commission's order in D.91-07-044, Pacific and GTEC propose to introduce a tariffed service for IECs to allow them to list their individual 10XXX dialed access codes and rate table information in the LEC's white pages directories.

GTEC also proposes to assess an annual rate that varies with the distribution of the directory for a listing of 10XXX code and IEC rate table information in the dialing instructions section of the white pages directory. No party commented on these proposals, and the proposals are adopted.

8. Returned Check Charge

Pacific proposes no change to its present charge of \$ 7.00 for each check tendered for payment [*102] of utility charges that is returned as unpayable.

GTEC proposes to increase its present returned check charge of \$ 10.00 to \$ 15.00. GTEC justifies this increase as necessary to cover GTEC's direct cost of processing a returned check, which is \$ 11.30. GTEC asserts that other ratepayers should not have to bear the cost of this service.

We have adopted Category I pricing for returned check charges. Under our pricing formulas, the price for GTEC should be the higher of the current price of \$ 10.00 or the DEC of \$ 11.30. We therefore adopt \$ 11.30 as GTEC's returned check charge.

9. Inside Wire Maintenance

The monthly recurring rates for GTEC's optional "Lineskeeper Service" and Pacific's comparable inside wire maintenance service n14 are as follows:

Monthly Rates		
Inside Wire Maintenance	GTEC *	Pacific **
Residential Services	\$ 0.95	\$ 0.60
Business Services	1.95	1.00

* GTEC also charges an \$ 85 nonrecurring charge to initiate the service for existing customers.

** Pacific has no fees to initiate service. (Special Condition in Schedule D-41.)

n14 In D.92-01-023, as modified by D.93-08-022, we approved a settlement that, among other things, increased Pacific's monthly rate for business services to \$ 1.30. In keeping with the assumptions of this proceeding, we will not recognize this increase in the revenue rebalancing or in the rate tables, but this treatment does not change the current rate for this service. [*103]

The LECs have requested no change to their rates for inside wire service, and therefore none is adopted, with one exception. In our proceeding to establish rates for inside wire maintenance services of LECs, we stated, "we will monitor Pacific and GTEC's pricing practices pursuant to D.89-10-031. . . . [I]f prices appear unreasonably high, we will not hesitate to order changes to the utilities' tariffs." (Re Pacific Bell, D.90-06-069, 36 CPUC2d 609, 620.)

D.90-06-069 noted that Pacific and GTEC should use DEC as the proper costing method for inside wiring maintenance service. Since Pacific and GTEC have not tendered the nonrecurring costs of inside wire maintenance for IRD review, there is no cost support for GTEC's continued collection of \$ 85 from a customer ordering inside wire maintenance service after initiating basic service. The \$ 85.00 charge for subscription to inside wire maintenance is unreasonable and should be deleted.

If GTEC believes that elimination of the \$ 85 initial charge will result in customers' subscribing to its Lineskeeper Service only after the need for inside wire repair service arises, it may in its tariff provide for a reasonable (e.g., [*104] 30-day) waiting period between the date the customer subscribes to the service and the date coverage of repairs under the service begins.

10. Phase-In Proposals

Pacific proposes to increase both the monthly rate and the nonrecurring service connection charges for residential basic exchange service over three years. DRA opposes Pacific's plan to gradually increase revenues from monopoly services, such as basic exchange service. DRA claims that a phased increase unfairly creates a fund to underwrite Pacific's transition into competitive services, thus buffering Pacific from competition. We agree with DRA that a one-time adjustment is cleaner and more equitable to consumers and competitors.

GTEC similarly claims that the five-year phase-out of transitional support payments from Pacific requires it to increase its basic rates over a five-year period. Elsewhere in this decision we provide that the revenue requirement represented by Pacific's transition payments will be collected in GTEC's own post-IRD rates. Thus, there is no need for a phased increase in GTEC's basic exchange rates.

11. Suburban Mileage

In some rural areas, exchanges are structured to have two areas: [*105] a heavily populated base area and a suburban area outside of the base area. Basic exchange service is provided to customers in the suburban areas at a higher, mileage-based rate.

Pacific proposes to simplify its billing and tariffs by eliminating suburban mileage charges and serving the suburban customers in these exchanges at the same rate as corresponding customers in the base area. Pacific estimates that the net revenue reduction from eliminating suburban mileage will be \$ 3.1 million. DRA concurs in Pacific's recommendation and estimate of revenue effects.

We agree that the tariffs should be simplified by eliminating suburban mileage for Pacific. We will recognize the net revenue reduction of \$ 3.1 million in the rate rebalancing.

Suburban mileage for small and mid-sized LECs is discussed in Chapter XI.

12. Future Adjustments

The post-IRD rates for basic exchange access services reflect a fair allocation of the costs of providing these services. No further increases to either the recurring rates or nonrecurring charges are justified at this time, and we do not believe that basic exchange rates should be moved to full DEC in the near future. We have adjusted prices [*106] as far upward as we believe is equitable or required. We acknowledge, however, that the DEC's relied on in this record are based upon 1989 and 1990 cost studies and represent companywide averaged costs of monthly access. We will authorize further upward movement of

costs of basic exchange services, if justified, only after examining such questions as whether company average costs are accurately stated, how average costs are computed, whether de-averaging is more equitable or is necessary to meet future competition, whether costs have decreased, and whether cost studies and cost study methodology should reflect DEC or LRIC. We are concerned that GTEC's costs of basic exchange services are significantly higher than Pacific's, and we would require a full audit and examination comparing the two LECs' costs before accepting any movement closer to DEC by either GTEC or Pacific.

IV. Foreign Exchange

A. Description of FEX

Foreign Exchange Service (FEX) permits a customer in Exchange "A" (home exchange) to have a telephone number associated with Exchange "B" (foreign or dial tone exchange). FEX allows a customer to have a telephone number presence in a community other than [*107] the one where the customer equipment is physically located. The customer receives dial tone from the foreign exchange so that calls to and from other customers in Exchange B are local calls instead of toll calls.

FEX may be provided in three ways. The predominant form is "line haul" foreign exchange, where the customer is connected by an ordinary access line to its serving wire center and is then connected by a dedicated facility to the foreign exchange wire center which generates the dial tone. For "cross-boundary FEX," an access line is extended from a contiguous foreign exchange to the customer's location (which is generally close to the exchange boundary). Under a "dedicated prefix" arrangement, the customer's ordinary access line is assigned a prefix which is dedicated to functioning as a prefix in a foreign exchange.

FEX is currently priced according to four basic rate elements. The customer must pay a recurring access rate for the connection between the customer's premises and the home exchange central office. A separate FEX increment is assessed for setting up and maintaining the FEX connection to the foreign exchange; GTEC combines the access and FEX increment into [*108] a single rate for its business and CentraNet customers. The third element is an FEX mileage rate based on the distance between the home exchange and foreign exchange connected by the dedicated facility. GTEC measures this mileage differently depending on the way FEX is provided. The fourth element is the usage rate that applies to local measured service for the dial-tone exchange (residential flat rate FEX would not incur local usage charges). In addition, each LEC assesses a nonrecurring installation charge for initiating service.

FEX presents arbitrage opportunities. Centrex-based telecommunications managers may aggregate calls that would ordinarily be charged as toll calls and transmit them over FEX lines. These Centrex-based managers can charge their customers up to the tariffed toll rates, while limiting their costs to the FEX charges.

B. Pacific's and GTEC's FEX Rate Proposals

1. Pacific

Pacific claims that its proposed FEX rates, when viewed with its proposals to reduce access charges and toll rates, present customers with "more sensible economic choices" for toll services. Pacific proposes to price FEX services, on average, at DEC, which will eliminate [*109] the current subsidy. Pacific also

supports higher FEX rates because it believes that "toll aggregators," such as CENTEX, should not be able to arbitrage a low FEX rate by using it as a toll substitute.

Pacific proposes to increase the access rate for FEX to correspond to increases in residential and business basic exchange service. Pacific would increase the residential foreign exchange increment by a percent equal to its proposed increase for residential access lines (that is, basic exchange service). This amounts to a 60% rate increase over a three-year period. The business FEX increment would increase to DEC. During the first year, the FEX increment for both types of residential service would increase by 35%; the FEX increment for business service would almost double.

Pacific would not change its FEX residential usage rates, but would increase business and Centrex usage rates during the day period from \$ 0.048 to \$ 0.06 per initial minute and from \$ 0.012 to \$.0216 per additional minute.

Residential nonrecurring charges would be increased over a three-year period by 63%, the same percentage increase proposed for residential access nonrecurring charges. This results in [*110] an increase from \$ 260 to \$ 351 per FEX connection in the first year, and to \$ 424 in the third year.

Pacific proposes increases in the nonrecurring charges for business. It would set the third-year price for business FEX above DEC.

Pacific acknowledges that FEX bills for high-usage customers may exceed DEC because FEX mileage and usage rates exceed cost.

2. GTEC's Proposed FEX Rates

GTEC proposes to raise its business access rate (which includes the increment) from \$ 31.55 to \$ 50.00, which is well above DEC. It would increase the residential increment from \$ 5.00 to \$ 10.00, resulting in a flat rate of \$ 25.55 and a measured rate of \$ 18.15. These rates are still below DEC. GTEC proposes to increase the nonrecurring charge to \$ 250.00, which is approximately the DEC of the service. GTEC proposes to retain its current mileage structure and mileage charges until meet-point billing, discussed below, can be implemented. GTEC concurred in DRA's proposal to decrease FEX residential usage rates and increase FEX business usage rates.

3. DRA

DRA views FEX as a nonessential Category I service which is not readily substitutable. DRA concluded that FEX overall is currently [*111] priced below cost.

DRA notes that business FEX is currently priced below DEC, but would tolerate some subsidy due to the difficulty of substituting for this service. DRA criticizes Pacific's analysis of nonrecurring costs, but accepts Pacific's presentation of residential FEX nonrecurring costs and recommends those rates be increased to FAC for noncontiguous FEX routes. DRA proposes no change to the charge for contiguous FEX routes because the charge is already at DEC. DRA recommends increasing the FEX increment for residential subscribers by 24.5%, the same percentage increase DRA proposes for residence access line rates.

DRA also asserts that Pacific's proposed rate for business FEX installation is considerably less than Pacific's estimated cost. DRA recommends that it be increased to the FAC level reported by Pacific on November 15, 1991. Only contiguous FEX lines (as distinguished from contiguous trunks) would be affected, as noncontiguous lines are currently priced above FAC.

DRA believes that installation charges for contiguous service and noncontiguous service should be different because Pacific's current tariff imposes different charges. DRA also believes that Pacific's [*112] cost estimate for the FEX increment is too high because Pacific used less than the actual number of lines to calculate costs. Pacific did not include lines provisioned under a dedicated prefix serving arrangement. DRA claims it is inappropriate to charge all FEX customers the same rate and that the Commission should rely on total volumes to establish FEX increment rates. DRA proposes to increase the business FEX increment by 52%, the same percentage increase DRA proposes for business exchange access lines.

4. CENTEX

CENTEX opposes the LECs' proposed rate designs. CENTEX maintains that FEX rates should be increased only if rates fail to cover their LRICs. The LEC cost studies show that FEX is currently priced well above cost, therefore, according to CENTEX, rates should not be increased.

CENTEX proposes to eliminate the FEX increment, the 20% differential between the local measured usage rate and the FEX usage rate, and the loop portion of CentraNet FEX because according to CENTEX, these rates are not associated with any LEC costs.

C. Discussion

FEX is a service that cannot be exactly duplicated and most of its service elements may be considered monopolistic. [*113] For these reasons, FEX is a Category I service. No party proposed that we change its status.

As a Category I service, FEX rate elements for Pacific will be priced at DEC minus 5% and for GTEC at the existing price or DEC, whichever is higher.

1. Three-year vs. One-year Increase

Pacific proposed phasing in its increase to the FEX nonrecurring charge and the monthly FEX increment over three years, as it recommended for other below-cost services. In Chapter III, we adopted a rate increase for basic exchange service to take full effect at the implementation of IRD. The authorized increase in FEX rates will likewise take effect on the implementation date for the reasons discussed in Chapter III.

2. FEX Access Rate

Because FEX access is no different from basic exchange service, we set FEX access rates equal to business and residential basic exchange rates. For Pacific's business FEX, we adopt an access rate based on the DEC of the FEX access line, less the EUCL, minus 5%. Thus, Pacific's monthly recurring rate for business FEX will be \$ 10.32. (See the table at the end of the chapter.) Its monthly rate for a FEX assured trunk, described in Chapter IX, will be \$ 12.86. [*114] Pacific's rate for residential FEX will be \$ 6.00 for single-party measured rate service, \$ 11.25 for single-party flat rate service, and \$ 6.60 for four-party flat rate service, which Pacific must convert to single-party service within one year (see Chapter III).

Pacific's Centrex FEX customers do not pay an FEX local access line charge because Centrex FEX customers pay for local access through Centrex rates.

GTEC's rates for residential FEX will be \$ 10.00 for measured rate service and \$ 17.25 for flat rate service. GTEC bundles its access and increment rates for business and CentraNet customers. The bundled business rate for access and the FEX increment will be \$ 31.55, which is the current price and above DEC.

GTEC's tariff requires CentraNet FEX customers to pay a local access line charge bundled with the FEX increment. Because CentraNet rates include an access component, CentraNet FEX customers pay for local access twice. We agree with CENTEX that GTEC's CentraNet FEX customers should not be required to pay redundant access line charges. GTEC shall file an unbundled tariff removing the access line component of FEX for CentraNet customers by subtracting the business [*115] access rate of \$ 19.22 from the bundled FEX rate of \$ 31.55. With the \$ 19.22 removed, the increment-only rate for CentraNet customers becomes \$ 12.33.

3. FEX Increment

CENTEX asserts that the FEX increment does not correspond to any identifiable cost and that its sole purpose is to maintain a rate differential between basic exchange access lines and FEX lines. CENTEX argues that DRA's support of the increment is inconsistent with DRA's proposal to price Category I services (except residential access lines) at FAC because, according to CENTEX, and FEX increment has no associated cost. Pacific replies that the FEX increment recovers the cost of terminating gain equipment and equalization equipment necessary for FEX service but not used with ordinary business loops. GTEC's witness also testified that the FEX increment corresponds to an actual cost.

Pacific and GTEC convince us that the FEX increment recovers the cost of additional equipment necessary for FEX service. Pacific and DRA proposed to increase the FEX increment rate by the same percentage increase they recommended for the basic exchange rate. For residential service, however, the associated price would be set [*116] below cost. Consistent with our Category I pricing policy, we set Pacific's monthly FEX increment at DEC minus 5% for both residential and business customers.

GTEC's residential increment rate will be \$ 9.28, which is the derived DEC for the service. As mentioned previously, GTEC bundles its access and increment rates for business and CentraNet FEX customers.

4. FEX Mileage

GTEC currently measures mileage differently (e.g., wire center to wire center, from a customer's premises to the nearest point on the common exchange boundary, or rate center to rate center) depending on the type of FEX service. GTEC had originally proposed to simplify its mileage rates, but withdrew this proposal after concurring in DRA's proposed rates.

Pacific recommends that the Commission require mileage measurement on a wire center-to-wire center basis for all contiguous and noncontiguous FEX. We find that the issue of how to measure FEX mileage would best be addressed by an industry proposal for restructuring of FEX mileage measurement and meet-point billing discussed subsequently in this section. Until we receive the LEC applications with new mileage methodologies and a meet-point billing [*117] plan, no change will be made to FEX mileage rates for GTEC, and Pacific's FEX mileage rates will be set at DEC minus 5%.

5. FEX Usage

Pacific's and GTEC's current FEX usage rates are 20% higher than other local usage rates. Pacific and DRA indicated that there is no difference between the costs of local usage for FEX and ordinary local usage. However, DRA reasoned that the multiplier should be maintained to parallel the increases applied to other local usage rates.

We adopt local usage rates for non-FEX customers in Chapter III. Because the costs of FEX usage and ordinary local usage are identical, for Pacific our adopted FEX usage rates will be identical to the local usage rates adopted in

Chapter III. For GTEC, we maintain the current FEX usage rates, including the 20% differential, because of the need to retain revenue in the rebalancing.

Currently, Pacific's measured rate residential customers can apply their monthly measured service allowance for local and ZUM calls to comparable calls placed from the dial tone exchange. Because we have set Pacific's FEX and ordinary usage rates at the same level, we will also apply the ordinary residential measured service allowance [*118] (\$ 3.00/month) to residential measured FEX. The FEX allowance does not include ZUM calling.

6. Nonrecurring Installation Charges

Application of our Category I pricing principles results in some changes for certain FEX installation charges. For business service, Pacific's installation charges decrease. Pacific's charges for residential installations increase.

GTEC's rate structure is simpler than Pacific's. The adopted nonrecurring charge for FEX is \$ 252.61, which is DEC, regardless of whether the underlying service is residential flat rate, residential measured rate, or business.

D. Meet-Point Billing

Currently, if an FEX customer's dial tone exchange is in the territory of an LEC other than the LEC providing the home exchange, the customer is billed by one of the LECs for the entire charge. The revenue is split so that the company providing the dial tone gets the access rate revenues and the other company gets the FEX increment revenues. Toll revenue goes to the company where the call originated and the two LECs split the FEX mileage revenue.

Under meet-point billing, each LEC would bill for its portion of the service. The customer would receive two separate [*119] bills which would contain a more accurate division of the costs and revenues. Once meet-point billing is completely implemented, the LECs will not have to go through the process of allocating the FEX revenues between them.

GTEC, Pacific, and DRA recommend that the Commission adopt meet-point billing for FEX. Meet-point billing requires both the home exchange LEC and the foreign exchange LEC to have meet-point billing capability, so it cannot be implemented until Pacific, GTEC, and the other LECs that provide FEX institute a plan for rating mileage. Pacific's recommendation to measure mileage on a wire center-to-wire center basis would appear to reduce customer confusion.

We will require the LECs providing intercompany FEX to jointly develop a meet-point billing proposal for FEX and to submit it to the Commission as an application by January 1, 1996. The proposal should consider use of wire center-to-wire center mileage measurement and identify revenue impacts of mileage price changes, customer impacts, specific meet-point billing procedures, implementation time periods, and implementation costs.

GTEC recommends that meet-point billing be implemented via the advice letter process [*120] according to a schedule adopted by the Commission. However, the potential size of rate changes to some customers warrants an application. In order to advise FEX customers of the potential rate effects of meet-point billing, we prefer the application process so that customers receive maximum opportunity to participate in discussion of rate impacts.

E. Foreign Prefix Service

Foreign prefix service (FPX) is offered to customers who wish to give the appearance of local presence in a foreign exchange. When call volumes are small, FPX is less expensive than FEX.

FPX has been a Category I service. No party proposed changing this designation and we therefore retain it. While DRA proposed keeping FPX rates and charges consistent with FEX rates and charges, neither LEC proposed making any changes. For GTEC, FPX mileage rates will remain at current levels. For Pacific, foreign prefix mileage rates will be set at DEC minus 5%.

F. Adopted FEX Rates

The following FEX rates are adopted for Pacific and GTEC:

	Pacific	GTEC
Residence (Flat-Rated) FEX		
Access Connection	\$ 11.25	\$ 17.25
FEX Increment	24.70*	9.28
Mileage	DEC-5%	No change
Usage	Not applicable	Not applicable
Residence (Measured) FEX		
Access Connection	\$ 6.00	\$ 10.00
FEX Increment	24.70*	9.28
Mileage	DEC-5%	No change
Usage	DEC-5%	No change
Residential Usage Allowance	3.00/Month	None
Business FEX		
Access Connection	\$ 10.32	\$ 31.55 (combined)
FEX Increment	24.70*	access & increment)
Mileage	DEC-5%	No change
Usage	DEC-5%	No change
CentraNet FEX		
Access Connection		Included in CentraNet line charge
FEX Increment		\$ 12.33
Mileage		No change
Usage		No change

[*121]

* This increment rate does not apply to Rate Areas A, B, C, and Noncontiguous, for which Pacific provided separate DEC's. Those rates are set at their DEC's minus 5%.

The following nonrecurring charges are adopted for FEX service:

	Pacific	GTEC
Residence		
Contiguous	\$ 503.50	\$ 252.61
Noncontiguous	503.50	252.61
Business		
Contiguous	370.50	252.61
Noncontiguous	370.50	252.61

V. Dedicated Access

A. Introduction and Summary

Access is an LEC service which connects a customer to an LEC central office. n15 Access may be switched or dedicated. The most common form of switched access is basic exchange service which is treated in the basic exchange chapter. Dedicated access is not switched by the LEC even though it is routed through the LEC's central office. It is known as "dedicated" because no traffic other than an individual customer's is carried over the dedicated access wires.

n15 Three terms for LEC termination facilities are used almost interchangeably, but have slightly different meanings which may, depending on the circumstances, be critical:

Central office: a generic term which refers to any telephone company switch;

End office: refers to an LEC Class 5 office;

Serving wire center: a building that could house several central offices.

[*122]

Dedicated access may take the form of either a private line, which connects two customer locations, or special access, which connects a customer to an IEC.

Private line services allow for communications from one customer location to another customer location within the same LATA without the use of the LEC's switches. Special access circuits are identical to private line circuits, except that one leg of the special access connection is to an IEC point of presence. The IEC then carries the communication across the LATA boundary. If the distant end user location is in the same state, intrastate tariffs apply; if the distant point is in another state, interstate tariffs apply.

These circuits, in turn, are categorized into either digital or analog technologies. Analog services use conventional wire connections to transmit electrical impulses. These include metallic, telegraph, voice grade, audio/video, and other miscellaneous services. Digital services use a train of high speed pulses and carry signals in a digital form. Digital services are provided through either Advanced Digital Network Service (ADN), Digital Data Service (DDS), n16 or High Capacity Digital Private Line Service [*123] (HICAP) facilities. Analog services are primarily classified on the basis of function. Digital services are primarily differentiated on the basis of transmission speed. n17 A customer's purchase of a particular private line does not necessarily limit the customer to the specific application for which the service is initially acquired. Rather, the customer's use is limited only by the technical capabilities of the connecting circuit.

n16 GTEC's version of DDS is Premium Digital Special Access (PDSA) and its version of ADN is Basic Digital Special Access (BDSA).

n17 DDS and ADN transmit information at speeds of up to 64 kbps. HICAP transmits information at 1.544 Mbps; this is known as DS1 service.

Unlike toll services, private line service is not charged on the basis of actual usage; private line services are rated on the basis of a flat monthly charge independent of the volume of traffic. This means that recurring monthly rates for these services constitute their entire contribution to the LEC for furnishing the service.

A summary of the pricing policies adopted for GTEC's and Pacific's analog and digital services is shown in the following tables.

Table V-1

Adopted Pricing [*124] Policies

		Pacific	
SERVICE	ADOPTED	PRICING	PRICE
Analog	CATEGORY	PHILOSOPHY	FLOOR
Telegraph (Obsolete)	II	Company proposed (if above the price floor)	LRIC/DEC (whichever is lower)
Metallic (Obsolete)	II	Company proposed (if above the price floor)	LRIC/DEC (whichever is lower)
Program Audio	II	Company proposed (if above the price floor)	LRIC/DEC (whichever is lower)
Voice Grade (Except mileage)	II	Company proposed (if above the price floor)	LRIC/DEC (whichever is lower)
Digital			
DDS (Obsolete)	II	Company proposed (if above the price floor)	LRIC/DEC (whichever is lower)
ADN	II	Company proposed (if above the price floor)	LRIC/DEC (whichever is lower)
HICAP	II	Company proposed (if above the price floor)	LRIC
GTEC			
SERVICE	ADOPTED	PRICING	PRICE
Analog	CATEGORY	PHILOSOPHY	FLOOR n1
DC/Metallic (Obsolete)	II	Company proposed (if above the price floor)	DEC
Program Audio	II	Company proposed (if above the price floor)	DEC
Voiceband	II	Company proposed (if above the price floor)	DEC
Alarm Transport	II	Company proposed (if above the price floor)	DEC
Digital			
PDSA/BDSA	II	Company proposed (if above the price floor)	DEC
HICAP	II	Company proposed (if above the price floor)	DEC

[*125]

n1 The price floor could incorporate LRIC when LRIC is available.

B. Positions of the Parties

Pacific, GTEC, and DRA each propose to amend the dedicated access rate structure. While they all agree on certain areas of concern, they differ on the priorities they give to these concerns and on specific rate levels. One concern is the fact that intrastate dedicated services are offered from two tariffs (intraLATA from the private line tariff and interLATA from the special access tariff). While these services are fundamentally the same in terms of both their use and the equipment required for the communication, their pricing structures and rate levels are very different. Pacific, GTEC and DRA found many analog private line services to be priced below their cost. Additionally, they were concerned about the pricing disparity between intra and interexchange mileage service with no apparent cost-based reason. Mileage rates for intraexchange analog private lines are substantially below the LECs' reported DEC; interexchange rates are close to DEC.

Pacific, GTEC, and DRA identified the following issues with respect to private line/special access services:

- (1) Classification [*126] of Private Line and Special Access services as Category I or Category II services,
- (2) Combination and simplification of private line and special access tariffs,
- (3) Limitation of obsolete service offerings,
- (4) Adoption of rates and charges for all private line services to recover their costs, unless grandfathered,
- (5) Implementation period for rate changes: one time or in steps,
- (6) Extension of meet-point billing to include all intercompany dedicated services in the new consolidated tariff, and
- (7) Revenue rebalancing treatment of pricing reductions for DDS and HICAP.

1. Pacific's Position

Pacific's proposal for private line and special access rates primarily consists of the following:

circle Analog:

- Below-cost rates increase over three years to the weighted average of their direct embedded costs (DEC) to mitigate rate shock.
- Once rates are at cost, recategorize them as Category II services.
- Grandfather all metallic and telegraph private lines at the weighted average of current rates.
- Grandfather mileage rates for existing intraexchange voice grade circuits at the weighted average of current rates.
- Adopt a single mileage rate for voice grade dedicated [*127] services.

circle Digital:

- Establish a price floor for competitive services.
- Reduce DDS prices to ADN prices.
- Grandfather variable speed ADN.

- Grandfather DDS service.

circle Both Analog and Digital:

- Consolidate into intrastate special access tariff.
- Unless grandfathered, establish one rate at or above DEC for each service rate element.

2. GTEC's Position

GTEC's objectives for dedicated access may be summarized as follows:

circle Pricing

- Cost-based pricing for analog service.
- Grandfathered pricing for DC/metallic.
- Competitive pricing for voice-grade, low-speed digital, and high-capacity services.
- All private line and special access rates priced at cost, i.e., DEC, within 3 years.

circle Avoidance of rate shock

circle Prevention of arbitrage

circle Consolidation of intrastate tariffs (both interLATA and intraLATA) along the lines of its interstate private line tariff.

3. DRA's Position

DRA urges increasing private line rates to the level of the LECs' weighted average DEC, thereby eliminating existing cross-subsidies, primarily by basic exchange service residential ratepayers. According to DRA, this larger perspective should eclipse any [*128] complaints of private line customers about service-specific rate increase proposals.

DRA does not consider any private line service to be "essential," i.e., it is not the type of service for which below-cost pricing is appropriate. DRA does not dispute that users of those services (the same as users of most services) consider them essential for their own needs. DRA's conclusion is based on the services being partially competitive or that alternatives to these services are available, noting the Commission's criteria in our Phase II decision, D.89-10-031.

DRA's proposals for private line and special access services include the following:

circle Eliminate distinction between private line and special access

- Single tariff for both.
- Use same tariff format for all services.
- With intraLATA competition, allow intraLATA private line customers to interconnect with IEC facilities directly.

circle Analog private lines - raise rates to DEC

- Metallic service - grandfather service (can change legs but no new backbones); but rates to DEC.

circle HICAP/DDS - leave rates where they are

- Pacific's DDS - grandfather service.

circle Intraexchange and interexchange interoffice transport [*129] at same rates

circle Extend meet-point billing to include all intercompany dedicated services.

C. Classification Under NRF Competitive Categories

1. Introduction

From the standpoint of technical capability, there are now numerous substitutes and alternatives for intraexchange and interexchange private line and special access services. More are expected to be available as both technical and regulatory constraints are resolved. These include radio or satellite-based systems which offer digital alternatives, long distance carriers, fiber bypass networks, local area networks, personal communications networks, and perhaps cable TV. It also includes the toll networks of LECs and their competitors.

According to Pacific, the alarm industry, once identified as a major consumer of private line service, now uses predominantly switched residential and business access lines equipped with dialers. Given the toll decreases approved herein, toll service will become an even more attractive substitute for interexchange private lines where failsafe service (with its correspondingly higher cost) is not a requirement.

Pacific states that competition for private line/special access [*130] service exists and is growing. This is supposedly shown by the fact that the number of analog private line circuits continues to decline without any price increases since 1988.

Pacific seeks Category I (monopoly) treatment of below-cost private line services at least until rates have been raised to DEC. Pacific would grandfather certain services and increase below-cost analog private line rates to DEC over a three-year phase-in period; only then will it evaluate the need for pricing flexibility.

GTEC also proposed to maintain its below-cost private line services in Category I during its proposed three year transition period to DEC-based prices. GTEC would accept the shift of private line services to Category II as long as it is not forced to reduce prices for competitive services immediately after IRD in order to stave off losses to its competitors.

DRA advocates the immediate increase of rates as necessary to ensure that all private lines, including all analog services, are at DEC and their concurrent recategorization as a Category II service.

2. Analog Services

As is discussed elsewhere in this chapter, obsolete analog services will be grandfathered to allow only minor [*131] modifications to existing systems, i.e., new legs, but no new backbones. For all other viable analog systems, there exist functionally equivalent, if not identical, services. Thus, all analog private lines are already competitive or are discretionary. Therefore, we will recategorize all analog services as Category II services, even though some of the older technology services are obsolete and will be grandfathered. Categorization does not necessarily reflect competitiveness of rates or service for this group.

3. Digital Services

Pacific proposes that all digital private line/special access services be placed immediately in Category II because they are discretionary services and Pacific faces actual or potential competition. Pacific anticipates that the Commission will approve competition for these services, but it requests flexible pricing authority only for the high capacity (1.544 mbps) digital service, which was placed in Category II by the Phase I decision on alternative regulatory frameworks, D.88-09-059.

GTEC proposes to move digital services to Category II. They state that there are competitive alternatives to these services, such as private networks.

Since digital [*132] services are either discretionary or partially competitive, all digital services shall be placed in Category II as requested by the companies.

Table V-2. Digital Services		
Pacific Service	GTEC Service	Speed
DDS	PDSA	Up to 64 kbps
ADN	BDSA	Up to 64 kbps
HICAP	HICAP	1.544 Mbps/DS-1 Service

D. Simplification of Private Line and Special Access Tariffs

1. Tariff Consolidation

a. Pacific

(1) Merger of Private Line Tariff into Special Access Tariff

Pacific contends that with the opening of the LATAs to competition, the continued maintenance of multiple tariffs for virtually identical services would present unnecessary administrative burdens. Pacific recommends a consolidation and restructuring of most Private Line/Special Access tariffs.

Currently two separate tariffs (along with numerous internal subparts) contain the various private line, special access and "private line-like" services. Most of Pacific's dedicated access circuits are provided under Pacific's federal tariff, which contains terms similar to those of its intrastate special access tariff.

Pacific recommends removing most of the components of the private line tariff (B Tariff), [*133] combining them into the special access (175-T) tariff and creating a uniform rate structure for this combined tariff.

The 175-T has one rate for each service category, e.g., 2 wire channel termination. The B tariff may have up to 15 separate types of 2 wire channel termination services and rates. We adopt Pacific's proposed consolidated tariffs. Not all of Pacific's private line services were included in this proposal. Pacific proposed moving some "private line-like" exchange services to the exchange tariff (A Tariff) along with other exchange services which they more closely resemble. The few services then remaining in the B Tariff, consisting of various components of obsolete and little used services, will continue to be offered from Pacific's B Tariff until subsequently modified by Commission action. While Pacific did propose to consolidate its Series 6000 Program Audio in the B-3 Tariff into its 175-T Tariff, the company did not provide sufficient data for the Commission to implement the merger and to include its effects in revenue rebalancing. While service 6000 is therefore

retained in the B-Tariff, Pacific may implement the merger by filing an appropriate advice letter [*134] independent of its IRD compliance filing.

The current and adopted arrangement of tariff components for Pacific are illustrated in Figure V-3.

Table V-3

Pacific Bell IRD Tariff Merger		
Tariff	Pre IRD	Post IRD
175-T	Metallic	Metallic (1000 Series)
	Telegraph	Telegraph (1000 Series)
	Voice Grade	Voice Grade (2000 & 3000 Series)
	Program Audio	Program Audio
	Digital Data Service (DDS)	DDS
	Advanced Digital Network (ADN)	ADN
	High Capacity (HICAP)	HICAP
B	1000 Series (Metallic/Telegraph)	Miscellaneous Private Line Services
	2000 Series (Voice Grade)	6000 Series
	3000 Series (Voice Grade)	
	6000 Series (Program Audio)	
	ADN	
	DDS	
	HICAP	
	Private Line Like (Secretarial lines, off premises extensions and tie lines)	
	Miscellaneous Private Line Services	
A		Private Line Like (Secretarial lines, off premises extensions and tie lines)

AT&T-C, DRA, and CENTEX support the merger of intrastate private line and special access tariffs. According to AT&T-C, the merger assists in preparation of the future OAND tariff environment where all customers will pay the same price for identical services, regardless of their customer classification or the use to which [*135] the service is put.

We find that since no functional capabilities will be lost as a result, portions of Pacific's B Tariff should be merged into Pacific's 175-T Tariff in keeping with Table V-3 above.

(2) Removal of "Private Line-Like" Services to "A" Tariff

As noted, Pacific does not propose that all of the B Tariff provisions be incorporated in 175-T. For those components related to "private line-like" services, Pacific proposes that they be joined with related components in the A Tariff which covers Exchange Services. These include secretarial lines, off-premises extensions, and tie-lines. These three services are currently offered in Pacific's exchange tariff. The relationship between these services and the B Tariff is limited.

DRA agrees with Pacific's plan to move certain "private line-like" services entirely to the A Tariff. CENTEX claims that off-premises extensions are not exchange services and should not be "moved" to Pacific's exchange tariff. n18 In fact, CENTEX takes issue with the proposed increase in off-premises extension rates which is the result of proposed rate increases to the analog private line mileage rates.

n18 Pacific's tariffs currently require the customer to pay private line mileage rates when interoffice transport is needed to provide the connection to the main customer location. An off-premises extension provides an extension of an existing customer station and telephone number at a main customer location to a remote location. An off-premises station provides a primary telephone service and telephone number to a location remote to a main customer location, such that the off-premises station can operate as part of the customer's main Centrex, PBX or key system. One common use is for connection to an answering service. [*136]

CENTEX is a toll aggregator with sufficient call volume to take advantage of high-capacity (digital) private line service. CENTEX asserts that off-premises extensions are actually digital private lines and should be priced at HICAP rates. Pacific's witness testified that the interoffice facility is like a private line and for that reason the rate for that portion of the service references the private line tariff. Although the line is typically a digital facility, it is not always a digital facility.

By characterizing an off-premises extension as a private line, CENTEX attempts to erase the critical distinction between a basic access line and a private line. In this manner CENTEX is again seeking the opportunity to aggregate end-user traffic over a dedicated line between the end-user and the serving wire center so it can resell exchange access service at a profit.

CENTEX has previously had its request for unbundled interoffice high capacity transport denied in D.90-03-073. We restate our rejection of competition for local exchange service at this time and hold that LECs are the only entities permitted to provide dial tone basic exchange service.

We find that the major [*137] difference between an exchange access line provided in the A Tariff and an off-premises extension is that the latter provides end-users with a specifically chosen basic exchange access line number (telephone number). To simplify the exchange service offering which uses off-premises extension, secretarial lines, and tie lines as a subpart, we authorize the placement of the private line portion of exchange services in the A Tariff.

(3) Merger of Intraexchange and Interexchange Mileage Rates

Pacific proposes to merge its intraexchange and interexchange mileage rates. n19 Historically, intraexchange service has been priced lower than interexchange service and generally below DEC. Interexchange private lines are close to DEC.

n19 Generally, intraexchange private line service involves only one wire center, although some exchanges may contain more than one wire center.

In D.85-09-078, private line mileage and channel terminal rate elements were divided into two distinct subcategories -- one for circuits that were intraexchange/intradistrict area in nature and one for those circuits that crossed exchange or district area boundaries. According to Pacific, this division caused [*138] rate distinctions leading to some intraexchange/intradistrict area rate elements being priced at as little as 10% of the price charged for the same rate element in an interexchange/interdistrict area circuit, although the cost to provide the circuits is the same.

CBCHA opposes the merger because according to CBCHA, it is based on a faulty cost study that presupposed that interexchange and intraexchange circuits are technically equivalent for like distances. This cost study, prepared by Pacific's cost witness, developed costs based upon total intraexchange/interexchange mileage, thus assuming that no cost differences exist between the two classes of circuits. In addition, CBCHA states that these services serve different functions; short haul private lines are never substitutes for toll service, while interexchange private lines may be so used. Finally, CBCHA asserts that Pacific has failed to recognize the increase in revenues from raising intraexchange private line rates to DEC. This omission would give Pacific an unaccounted-for windfall in additional private line revenues while at the same time, deprive customers of existing low rates.

Pacific claims that its examination of [*139] the methods for providing intraexchange and interexchange private line revealed no "cost-impacting characteristics" unique to each. In its defense, Pacific stated that the revenues gained from the rate increase will be offset by revenues lost due to the repressive effect of its proposed rate increases.

Two of the three services which differentiate mileage on an inter- or intraexchange basis are obsolete. To the extent not already done, Pacific has requested that they be grandfathered.

For the third service, voice grade, Pacific requests that mileage rates for existing intraexchange customers be grandfathered at a weighted average of current rates, which are considerably below DEC. This would apply to both fixed and variable mileage rates. This request is made to mitigate rate shock for existing customers. Existing interexchange as well as all new customers, regardless of being served on an inter- or intraexchange basis, would be charged Pacific's proposed interexchange rates, which would be set at or above DEC.

This decision does not adopt a policy of grandfathering rates for a subset of customers using a service which is not obsolete. Therefore, Pacific's request to grandfather [*140] intraexchange voice grade mileage rates is rejected.

In summary, Pacific's request to merge its tariff is approved.

(4) Costs for Implementing the Tariff Consolidation

Pacific seeks \$ 6 million in ratepayer funds to implement these tariff rearrangements. However, we note that as it is Pacific's own proposal to merge the tariffs, we cannot support ratepayer funding of this request. We therefore deny Pacific its \$ 6 million from ratepayers to fund implementation of the merger. As with other competitive products, Pacific's shareholders should bear the cost to improve customer service and enhance marketing through streamlined price proposals.

b. GTEC

Except for the interoffice mileage rate element, GTEC charges the same rates for intra- and interexchange private lines. In order to eliminate this exception, GTEC proposes to adopt one rate for the interoffice mileage rate element. GTEC proposes to combine private line and special access services into a single tariff and to adopt the C-1 tariff (interLATA access) format for these services. Other technology-specific tariffs would be merged with the interLATA access tariff or eliminated. IntraLATA private line analog service [*141] would be offered in the transitional P Tariff, which would be merged with the C-1 tariff after a three-year transition period. The G-11 tariff (existing alarm transport) would be merged into the P tariff.

GTEC's proposed intraLATA private line rates will not initially achieve parity with the rates in its interLATA tariffs; GTEC has proposed a three-year period to equalize all of its intraLATA and interLATA rates. By the end of the three-year transition period, GTEC's special access and private line services would be priced at DEC. GTEC placed both special access and private line services in the C-1 tariff.

AT&T-C and DRA concur in GTEC's proposal to combine private line and special access service as shown above into a single tariff. However, DRA disagrees with GTEC's proposal that rate increases for analog services be phased-in over a three-year period. DRA believes that all rates and charges should be increased to cover DEC and that the P tariff should be merged with the C-1 Tariff at the time of IRD implementation.

As the company has proposed, we authorize the consolidation of GTEC's intrastate private line and special access tariff schedules because the resultant schedule [*142] will enable GTEC to provide better customer service and mitigate the potential for tariff arbitrage. However, we concur with DRA that there is no benefit to phasing in this transition over three years. The stated purpose of this order is to enhance efficiency and to immediately move to cost-based pricing. Table V-4 shows the current and adopted tariff structure for GTEC.

Table V-4. GTEC's Tariff Restructuring	
Current Tariffs	Post-IRD Tariffs
C-1, InterLATA Access	C-1, InterLATA Access
P, IntraLATA Special Services Access Analog Services	C-1, IntraLATA Special Services Access Analog Services
G-7, Wideband	Eliminated
G-8, IntraLATA DDS	C-1, IntraLATA DDS
G-11, Alarm Transport	C-1, Alarm Transport
G-14, HICAP	C-1, HICAP
G-15, Switched Data Services	Eliminated
G-20, Closed Circuit	Eliminated

2. Restructuring the Rate Element Format

Pacific, GTEC, and DRA agree that the tariffs for all dedicated services (i.e., private line and special access) should be restructured into a consistent rate element format. The following five rate elements have been identified:

(1) Channel Termination (Pacific)

Special Access Line (GTEC)

Provides the transmission [*143] facilities between a customer designated location and the serving wire center,

(2) Mileage - Fixed (Pacific)

Special Transport Termination-New (GTEC)

Provides for interconnection to the trunk between wire centers, but is a fixed charge,

(3) Mileage - Variable Rate per Mile (Pacific)

Special Transport Facility-Mileage (GTEC)

Provides for the transmission facilities between the serving wire centers associated with two customer designated premises,

(4) Optional Features and Functions (Pacific) n20

Supplemental Features (GTEC)

n20 Pacific includes multiplexing in "Optional Features and functions" while GTEC has this as a separate element.

Provides options to improve the quality or functionality of a circuit,

(5) Multiplexing Arrangements (GTEC)

Convert a single higher capacity or bandwidth circuit for bulk transport to or from several lower capacity or bandwidth circuits.

We adopt the proposed rate element format.

E. Adopted Rates and Charges

1. Obsolete Services

Pacific has identified three services which it asserts are obsolete and offer functionality that is available from other dedicated access services or other substitutes. [*144] These are metallic, telegraph and DDS. With the exception of DDS, Pacific proposes to grandfather existing services within these categories, that is, to continue serving existing accounts at a weighted average of current rates and to limit enhancements of existing lines. DRA recommended immediately pricing these services at DEC. In its brief, Pacific stated that it does not oppose DRA's recommendation. GTEC proposes to grandfather DC/metallic service at existing rates.

a. Pacific -- Metallic and Telegraph

Pacific proposes to continue serving existing telegraph and metallic (analog) dedicated access lines at consolidated rates, which are a weighted average of existing rates, so long as the customers make no physical changes to the backbone circuits. Pacific would provide no new backbone circuits, but customers could continue to add legs to these circuits. DRA generally concurs with grandfathering the service and extension in this manner, but disagrees with continuing the use of existing rates. DRA recommends that the rates and charges for metallic and other analog private line services should be raised immediately to DEC, not frozen at current levels.

CAA objects that [*145] Pacific's prohibition against extensions of backbone circuits will prevent users from adding or changing their service locations.

Pacific responds that customers now employ alternatives to metallic private lines, and that a new location can be served with metallic private line so long as the alarm company already has a backbone to the central office which serves its new alarm customer.

It is reasonable to limit deployment of this service as Pacific has proposed. Pacific is authorized to limit the provision of these identified services as described above, and to stop providing any new backbones.

With respect to rates, Pacific recommends grandfathering metallic and telegraph private line service at averaged existing rates.

Pacific proposed to grandfather rates for metallic and telegraph intraexchange mileage, while still maintaining the distinction between intra- and interexchange mileage as it currently exists in the B Tariff. However, the B Tariff is being merged into the 175-T Tariff in this order, and the 175-T Tariff does not distinguish between intra- and interexchange mileage. Therefore, to be consistent with the structure of the 175-T Tariff, we adopt consolidated mileage [*146] rates that are a weighted average of current rates in the two tariffs and eliminate the intra- and interexchange distinction which currently exists in the B Tariff. However, we will follow our Category II pricing principles and price at or above the appropriate price floor.

b. Pacific -- DDS Service

Pacific states that the equipment used to provide DDS is no longer cost effective, is unable to keep pace with user requirements, and in some cases is no longer available. ADN digital service gives the customer more flexibility at a lower tariff rate than DDS service. Pacific would reduce DDS rates to the level of ADN rates and grandfather DDS service under the same terms as metallic/telegraph private lines. DRA concurs in the grandfathering proposal but it disagrees with Pacific's proposal to decrease DDS rates. DRA counter-proposed that DDS rates should remain at present levels, where they are above DEC.

We have determined that DDS should be in Category II because of the discretionary nature of the service, rather than the existence of competitors to provide the service.

We will grandfather DDS service in the manner proposed by Pacific. We adopt Pacific's proposal to reduce [*147] DDS rates to ADN levels as long as the rates are above the floor.

Pacific should continue to apply a nonrecurring charge to DDS customers who switch to ADN.

c. GTEC -- DC/Metallic

GTEC proposed to grandfather its DC/Metallic services at current rates. As was the case for Pacific, this request will be granted with additions of legs permitted but no new backbones. In keeping with our Category II pricing rules, any rates currently below DEC will be raised to DEC.

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